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Sportsbooks Could Use Derivatives Market, But Is It Betting?

By **Zachary Zagger**

Law360 (February 17, 2021, 5:50 PM EST) -- The Commodity Futures Trading Commission is considering a proposal to begin listing futures contracts based on the outcomes of NFL games for sale on an exchange open to sports betting operators and stadium owners and vendors, a move attorneys say is brought on by the financial risks from state-by-state legalization of sports betting.

Futures market Eris Exchange LLC and a company called RSBIX are seeking to allow sportsbooks, vendors and stadium owners to purchase futures contracts based on the outcomes of NFL games, including money line winners, winners based on point spreads and even over-unders.

But the CFTC is currently considering whether the proposal amounts to mere sports betting or gambling through the futures market, and how it could affect the integrity of sports games as half the states have legalized sports betting.

While the contracts resemble typical sports bets, proponents say they serve an economic purpose, allowing sports betting operators and others in the sports industry to hedge risk using the derivatives markets like other industries.

"It is not really a bet. It is a hedge," said sports and capital markets attorney Baird Fogel of Morgan Lewis & Bockius LLP. "Think of it almost like insurance. You have sports betting operators and you have team owners with massive amounts of money invested in a particular event, say the Super Bowl or a regular season game."

ErisX is seeking approval from the CFTC, which regulates the derivatives market, to list the RSBIX NFL futures contracts for trading by licensed sportsbooks, stadium vendors and stadium owners with commercial risk. The exchange would further authorize designated market makers "to trade the products for the purpose of providing necessary liquidity," according to the proposal.

The CFTC public comment period closed at the end of last month. The agency has 60 days from then to respond.

"There are a good number of people in this industry who are on pins and needles watching this," Fogel said. "If this gets approved there is going to be a mass amount of pressure on other exchanges to approve this. You can imagine how widespread this can become."

Attorneys say the need for such derivatives is in large part due to the federal Wire Act's prohibition on interstate sports betting, which forces sports betting operators to silo their operations in states that have legalized it. That leads to situations where there is lopsided betting from consumers on the hometown teams.

For instance, in Pennsylvania, where sports betting is legal, if the Philadelphia Eagles were to make the Super Bowl, the sportsbooks in that state would likely see a lot of action on the Eagles. But for a sportsbook not to lose money should the Eagles win, it must try to balance the betting on both sides.

If sportsbooks operated on a nationwide or multistate basis, they would be able to balance the betting on both teams with bettors from outside of Pennsylvania. Right now, all they can do is manipulate the odds and point spreads to encourage more betting from Pennsylvanians on the opponent. The problem is these less favorable lines tend to turn bettors away or push them to persistently unregulated offshore books, gambling attorneys say.

"This commodities futures contract would allow those sportsbooks to lay off that risk through the national commodities exchange," said Behnam Dayanim, chair of the advertising, gaming and promotions practice at Paul Hastings LLP, who is counsel to RSBIX. "They could then enter into a futures contract with another sportsbook in another state or a market maker on the other team. That way they would not be exposed to that commercial risk."

Such an offering would not have been thought possible before the U.S. Supreme Court's decision in Murphy v. NCAA wiped away a federal limitation on states legalizing sports betting and spawned a growing legal market. However, sports betting is still only legal in half the states.

Further complicating matters, CFTC regulations prohibit the listing of a contract "that involves, relates to, or references terrorism, assassination, war, gaming, or any activity that is unlawful under state or federal law."

ErisX says its contracts are not themselves wagers or based on the outcome of wagers, but on the outcome of actual NFL games.

Gaming attorney Jeff Ifrah of Ifrah Law PLLC, who has also helped develop the proposal, said there are a few things that make this different from gambling. First, the participants in this market are limited to those with financial stakes in the outcome of the games. Second, while most sports bettors are placing bets as a form of entertainment, these contracts have a clear economic purpose, enabling the investors to hedge their real financial risks on the outcome of a game.

"You have to have commercial risk," Ifrah said. "Any industry who brings a future over to an exchange, whether it is oil or crypto or anything else, they all look like it is someone essentially gambling. But the difference, and the reason the CFTC exists, is to help businesses hedge their risk."

Still, attorney Jeremy D. Weinstein, an expert in commodities and derivatives trading compliance who submitted a letter to the CFTC urging it to deny the listing of these contracts, pointed out that the contracts themselves are based on typical sports bets: money line, point spread and over-under.

"It is to hedge gambling risk. OK, it may be legal gambling, but it is still gambling," he told Law360.

Weinstein said it may be difficult for the CFTC to police who is actually using this exchange. Even if participation in the market is limited, it will require speculators to take opposite positions, "so by definition there is somebody who is speculating on the points spread," he said.

The NFL has toed the line with support for these futures, and it is not clear whether the league would allow team owners who also own their stadiums to participate on this futures market even if they are doing so to hedge financial risk. For stadium and venue owners, whether or not a team wins or qualifies for the playoffs affects their bottom line.

Prior to the Murphy decision, the leagues were resistant to efforts to legalize sports betting, arguing it would hurt the integrity of their sports. In its comment letter to the CFTC, ErisX asserted the NFL "does not object to ErisX listing these contracts." However, Brendon Plack, NFL senior vice president for public policy and government affairs, disputed that characterization in a comment letter of his own, saying ErisX never sought the NFL's "permission to make that representation."

"At minimum, the NFL believes that more information is required to properly assess these types of futures contracts," Plack's letter said. "If the commission is considering approving them, the NFL would accordingly urge that such a decision be postponed pending a more comprehensive study."

Key questions include whether the money on the contracts is really tied to commercial risk, whether the contracts on the outcomes of NFL games might implicate other federal laws and whether the market makers should be involved.

At the same time, the NFL said it "takes no position here as to the purported market benefits of hedging vehicles for licensed sportsbooks." The NBA submitted a comment siding with the NFL.

With legal and regulated sports betting spreading throughout the U.S., attorneys aren't surprised the betting industry is looking to become more sophisticated and wants to mitigate commercial risk through the derivatives market like other industries.

Sports betting "always had a little bit of a black eye ... for good reasons and for bad reasons," Fogel said. "What the Supreme Court did is kind of remove that black eye from the industry and it has become popular. If people can figure out the right way to do it to protect integrity and limit fraud, it is a wonderful source of revenue and an exciting new industry for a number of players who were previously not able to" participate.

--Editing by Marygrace Murphy.