

A SECURITY BY ANY OTHER NAME: AN INQUIRY INTO STAKING AGREEMENTS AS SECURITIES

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I. INTRODUCTION

Friends of the 2017 World Series of Poker Tournament Champion, Scott Blumstein, had more to celebrate than just the nearly \$8.15 million their buddy recently won.² Along for the wild ride emotionally and financially, Blumstein's friends each contributed \$60 towards his tournament buy-in and were each subsequently rewarded in the amount of \$40,750 upon his victory.³ This practice of financially backing a professional competitor, commonly known as "staking,"⁴ provided Blumstein's friends an opportunity to capture not only a piece of Blumstein's glory, but also a return on their investment.

Common among many professional and competitive sports, including poker, golf,⁵ tennis,⁶ and recently popular eSports,⁷ a staking agreement is broadly defined as an agreement between a professional competitor and a benefactor in which the benefactor financially sponsors the professional to be able to compete,

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² See Jon Sofen, *Friends Who Invested in WSOP 2017 Main Event Winner Scott Blumstein Now \$40K Richer*, CARDSCHAT NEWS (July 26, 2017), <https://www.cardschat.com/news/friends-invested-wsop-2017-main-event-winner-scott-blumstein-40k-richer-49087>.

³ *Id.*

⁴ Leslie Albrecht, *How to turn \$60 into \$40,000: Invest in a poker player and get lucky*, MARKETWATCH (Aug. 1, 2017, 9:22 AM), <http://www.marketwatch.com/story/how-to-turn-60-into-40000-invest-in-a-poker-player-and-get-lucky-2017-07-31>.

⁵ See, e.g., Sutton v. Smith, 603 So.2d 693, 694 (Fla. Dist. Ct. App. 1992).

⁶ See, e.g., Julia La Roche, *Meet The 16-Year-Old US Open Tennis Phenom Backed By Bill Ackman*, BUS. INSIDER (Aug. 29, 2014, 1:23 PM), <http://www.businessinsider.com/bill-ackman-sponsors-us-open-francis-tiafoe-2014>

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⁷ See Will Green, *Esports Staking Industry Emerges With YouStake, Rivalcade Partnership*, THE LINES (Jan. 22, 2018), <https://www.thelines.com/esports-staking-industry-YouStake-rivalcade/>.

and in exchange, receives a return as a percentage of the competitor's resultant winnings.⁸ The split varies dependent upon the sport, and ranges from twenty percent⁹ to fifty percent¹⁰ of the player's winning proceeds.

Staking agreements made with poker professionals are not a new phenomenon, and have historically occurred between friends or acquaintances.¹¹ More often than not, these deals were (and many still are) informal in nature: the parties come to terms of the agreements orally and execute the arrangement by "handshake."¹² The informal nature of staking agreements has therefore kept these contracts hidden from the ever-watchful eye of state and federal regulatory agencies. This, however, is quickly changing. The recent emergence of online staking services, such as YouStake, IMAWHALE, ChipMeUP, and TastyStakes, has pushed the formerly back-room, handshake deals into the public spotlight, and both state and federal regulatory agencies have taken notice.¹³

Now aware of staking arrangements on a public level, the Financial Industry Regulatory Agency (FINRA) and the Securities Exchange Commission (SEC) have begun to investigate whether these agreements are securities as defined by the Securities Act of 1933.¹⁴ This Essay suggests that staking agreements, by their very nature, are securities. Part I includes an overview of how Nevada currently defines securities, as well as an analysis of how Nevada might define staking agreements under Nevada law and case precedent. This article's analysis focuses on Nevada because of the extensive gambling precedent that exists there and the historically pervasive poker staking in the state. Part II analyzes staking agreements through the lens of the federal securities definition test as proposed by *SEC v. W.J. Howey Co.*, commonly termed the "Howey test."¹⁵ Finally, Part III will analyze the potential consequences of state and federal regulatory agencies defining staking agreements as securities.

⁸ See Albrecht *supra* note 4.

⁹ See Sigel v. McEvoy, 707 P.2d 1145, 1145 (Nev. 1985).

¹⁰ See Donnie Peters, Jason Mercier Gives Insight into the World of Staking, POKERNEWS (Oct. 12, 2012), <https://www.pokernews.com/news/2012/10/jason-mercier-gives-insight-into-the-world-of-staking-13579.htm>.

¹¹ See Albrecht *supra* note 4.

¹² See Keith Romer, *Hedging Their Bets: How The Pros Diversify Their Poker Portfolios*, NPR (Mar. 24, 2016, 5:01 AM), <http://www.npr.org/2016/03/24/471684998/hedging-their-bets-how-the-pros-diversify-their-poker-portfolios>.

¹³ See YOUSAKE, <https://YouStake.com> (last visited May 15, 2019); IMAWHALE, <https://imawhale.com> (last visited May 15, 2019); CHIPMEUP, <https://www.chipmeup.com> (last visited May 15, 2019); TASTYSTAKES, <https://tastystakes.com> (last visited May 15, 2019).

¹⁴ Securities Act of 1933 § 2, 15 U.S.C. § 77b (2012). See, e.g., Haley Hintze, *YouStake Sues SEC, Seeks Declaratory Judgment Over Online Staking Legality*, FLUSHDRAW (July 7, 2017) <http://www.flushdraw.net/news/youstake-sues-sec-seeks-declaratory-judgment-online-staking-legality/>.

¹⁵ See generally *SEC v. W. J. Howey Co. et al.*, 328 U.S. 293 (1946).

II. STAKING AGREEMENT DEFINITIONS UNDER NEVADA LAW

A. *Staking Agreements as Investment Contracts Under Nevada Law*

In the spring of 1983, Tom McEvoy, a poker professional, entered into an oral agreement with Martin Sigel wherein Sigel would financially back McEvoy to enter the World Series of Poker Tournament hosted by Binion's Horseshoe Club in Las Vegas.¹⁶ In exchange for this capital funding, the staking agreement required McEvoy to pay Sigel twenty percent of any proceeds from his poker winnings arising from the tournament.¹⁷ McEvoy, later inducted into the Poker Hall of Fame in 2013,¹⁸ did not disappoint, and won two tournaments to the tune of \$657,000.¹⁹ Sigel later alleged that McEvoy had paid him only \$21,400 of the \$131,400 that McEvoy contractually owed Sigel.²⁰

In the litigation that followed, the poker champion argued that the \$110,000 difference was a gambling debt and thereby not legally enforceable in Nevada.²¹ The Nevada Supreme Court disagreed, citing case precedent wherein a contractual arrangement between two parties regarding payment via gambling winning proceeds was defined by the court as a "legitimate business arrangement" and therefore not a common law gambling debt.²² In so ruling, the Nevada Supreme Court had indirectly decided that a staking agreement made between a professional gambler and his or her benefactor was a legitimate business arrangement.²³

B. *Nevada Gaming Control Board*

Despite the Nevada Supreme Court's recognition in *Sigel* that staking agreements are legitimate contracts capable of enforcement, Nevada appears reluctant to attempt to regulate staking agreements outside of general contract principles. In 2015, the Nevada Legislature enacted a statute that made it

¹⁶ See *Sigel v. McEvoy*, 707 P.2d 1145, 1145 (Nev. 1985).

¹⁷ *Id.*

¹⁸ Seth Palansky, *Poker Hall of Fame Announces Class of 2018*, WSOP.COM (July 12, 2018, 10:48 PM), <http://www.wsop.com/news/2018/Jul/10710/POKER-HALL-OF-FAME-ANNOUNCES-CLASS-OF-2018.html>. See also *WSOP Player Profile: Tom McEvoy*, WSOP.COM, <http://www.wsop.com/players/profile/?playerid=238> (last visited Mar. 12, 2019) (Tom McEvoy became the World Series of Poker Tournament Champion in the 1983 main event tournament and has won, to date, approximately \$1.3 million dollars from poker tournaments around the United States).

¹⁹ *Sigel*, 707 P.2d at 1145.

²⁰ *Id.*

²¹ *Id.* See NEV. REV. STAT. § 463.361(1) (1983).

²² *Sigel v. McEvoy*, 707 P.2d 1145, 1146 (Nev. 1985) (citing *Johnston v. DeLay*, 158 P.2d 547 (Nev. 1945)).

²³ See *id.*

“unlawful for a person to receive. . .any compensation or reward, or any percentage or share of the money. . .upon the result of any event held at a . . . sporting event or other event. . .without having first procured. . .gaming licenses. . .”²⁴ When the professional poker industry learned of this legislation, many feared that it would prohibit poker staking absent expensive gaming licenses.²⁵ Quick to allay the fears of poker professionals and consumers, the Nevada Gaming Control Board Chairman assured players that the bill “related to sports betting only” and did not regulate poker in any fashion.²⁶

C. *Securities as Defined by NRS §90.295*

Despite the Nevada Gaming Control Board’s reluctance to regulate staking agreements, these now legitimate contracts meet the definition of a “security” under Nevada statutory law. In pertinent part, NRS § 90.295 states:

“Security” means a note, stock, bond, debenture, evidence of indebtedness, certificate of interest or *participation in a profit-sharing agreement. . .investment contract. . .*or, in general, any interest or instrument commonly known as a security. . .or participation in. . .whole or partial guarantee of or warrant or right to subscribe to or purchase any of the foregoing.²⁷

According to this statutory definition, it seems likely that Nevada would define staking agreements as securities. Staking agreements, by their nature, involve the participation of two individuals in a “profit-sharing agreement” wherein the investing benefactor is recipient to the “profits” of a professional competitor in return for their investment.²⁸

Nevada legislators have granted power to the state Executive Branch to further analyze and define terminology under Chapter 90 of the Nevada Revised Statutes “necessary for an understanding of the provisions of this chapter[.]”²⁹ In 1992, the Nevada Secretary of State issued an administrative interpretation of the term “investment contract.”³⁰ Nevada Administrative Code (NAC) § 90.090 defines the term “investment contract” (as used in NRS § 90.295) as:

²⁴ NEV. REV. STAT. § 465.086(1) (2015).

²⁵ See Katie Barlowe, *New Nevada Gambling Bill Could End Poker Staking Agreements (Or Not)*, CASINO.ORG (Jan. 26, 2015), <https://www.casino.org/news/new-nevada-gambling-bill-could-end-poker-staking-agreements-or-not>; Jason Glatzer, *Poker Players Won’t Be Affected by Anti-Staking Bill in Nevada*, POKERNEWS (Jan. 29, 2015), <https://www.pokernews.com/news/2015/01/will-nevada-prohibit-poker-staking-including-for-the-wsop-20467.htm>.

²⁶ See Jocelyn Wood, *Poker Staking is Safe in Nevada*, POKERFUSE (Jan. 28, 2015), <http://pokerfuse.com/news/law-and-regulation/26424-poker-staking-safe-nevada/>.

²⁷ NEV. REV. STAT. § 90.295 (2019) (emphasis added).

²⁸ See generally *id.*

²⁹ *Id.* § 90.750(1) (“The Administrator may adopt regulations further defining such words and terms as are necessary for an understanding of the provisions of this chapter and any regulations adopted pursuant thereto.”).

³⁰ NEV. ADMIN. CODE § 90.090 (2017).

1. Any investment in a common enterprise with the expectation of profit to be derived substantially through the efforts of a promoter or other third party; or
2. Any investment by which:
 - a. An offeree furnishes initial value to an offeror;
 - b. A portion of this initial value is subjected to the risks of the enterprise;
 - c. The furnishing of the initial value is induced by the offeror's promises or representations which give rise to a reasonable understanding that a valuable benefit of some kind over and above the initial value will accrue to the offeree as a result of the operation of the enterprise; and
 - d. The offeree does not receive the right to exercise practical or actual control over the managerial decisions of the enterprise.³¹

According to this interpretive definition, the Nevada Secretary of State could likely define staking agreements as investment contracts. The professional competitor party to a staking agreement receives capital from a benefactor in exchange for an initial value equal to a percentage of the competitor's resultant winnings.³² The percentage return a benefactor receives varies greatly but is often between twenty and fifty percent.³³

The benefactor's return is subject entirely to the competitor's success or failure within his or her competition. A benefactor receives nothing in return from a competitor that fails to win. The benefactor's return is also subject to the total amount given to the competitor as an award for winning his or her competition, and therefore the prize for placing first, second or third may vary greatly.³⁴

Next, a competitor induces a benefactor to fund their ability to compete by representing that the benefactor will receive a return that is often well above the initial amount provided to the competitor.³⁵ For example, the 2017 World Series of Poker Tournament Main Event required a \$10,000 buy-in with an \$8.15

³¹ *Id.*

³² *See generally* Peters, *supra* note 10.

³³ *See* Sigel v. McEvoy, 707 P.2d 1145, 1145 (Nev. 1985); Peters *supra* note 10.

³⁴ *See* Robert Kirschen, *Justin Bonomo Wins 2018 Big One For One Drop*, WSOP.COM (July 18, 2018, 2:48 AM), <http://www.wsop.com/news/2018/Jul/10723/JUSTIN-BONOMO-WINS-2018-BIG-ONE-FOR-ONE-DROP.html> (The 2018 World Series of Poker's "The Big One for One Drop" event drew twenty-seven participants and paid out \$10 million to the first place winner, \$6 million to the second place player, and \$4 million to the third place winner).

³⁵ *See generally* Sofen, *supra* note 2.

million first-place award.³⁶ A benefactor that funds the entire \$10,000 buy-in and receives *but a single percent* of a first place award is entitled to an \$81,500 return. Again, an agreement's agreed return on winnings is often much greater than one percent.³⁷

Finally, staking agreements generally do not allow the benefactor to manage the professional competitor.³⁸ Staking agreements do not allow the benefactor to manage how the professional competes, nor does it allow for the benefactor to manage the professional outside the competition, including how the competitor behaves prior to, during and after the competition.³⁹ A question may arise, however, if the terms of the agreement include a refund to the benefactor where the competitor does not specifically perform in competing; even in this circumstance, the benefactor does not manage the competitor in any fashion as to compel or dissuade him/her from competing, and therefore likely meets this last requirement under Nevada Administrative Code section 90.090.⁴⁰

D. NRS § 90.530(11) Registration Exemption

While Nevada might define a staking agreement as a security pursuant to NRS § 90.295, it is also likely that a staking agreement security is exempt from registration with the Nevada Securities Division. Nevada law requires offerors of a security to register the offering with the Nevada Securities Division prior to any sale of the security to the public.⁴¹ There are, however, exceptions to the registration requirement. In pertinent part, NRS § 90.530(11)(a) grants exemption from the registration requirement where “[t]he transaction is part of an issue in which there are not more than 35 purchasers in this State, other than those designated in subsection 10, during any 12 consecutive months. . . .”⁴²

A staking agreement, despite meeting the technical definition of a security, may therefore escape the registration requirements given the limited number of

³⁶ *Id.*

³⁷ *See Sigel*, 707 P.2d at 1145. *See also* Peters, *supra* note 10.

³⁸ *See* David Huber, *Lee Childs Wins Historic Court Case Between Backer and Stakee*, POKERFUSE (June 3, 2014), <https://pokerfuse.com/news/law-and-regulation/2014-06-03-lee-childs-wins-historic-court-case-between-backer-and-stakee/> (In 2013, a six-person jury in New Jersey found certain clauses in a poker staking agreement unreasonable because they placed burdensome requirements upon the competitor. These requirements included providing the agreement benefactor with a competition calendar six months in advance and that the competitor “always play to the best of [his] ability.”).

³⁹ *See id.*

⁴⁰ *See* NEV. ADMIN. CODE § 90.090(d) (2017). *See generally* David Zeitlin, *Mitchnick v. Childs, A Cautionary Tale of Actual Poker Justice*, DAVIDZEITLIN, <https://davidzeitlin.com/mitchnick-v-childs-a-cautionary-tale-of-actual-poker-justice/> (last visited May 15, 2019).

⁴¹ NEV. REV. STAT. § 90.460 (2019).

⁴² *Id.* § 90.530(11)(a).

individuals that partake in the agreement. The most common form of staking agreements, like the agreement between Mr. Sigel and Mr. McEvoy, involve but two individuals, only one of which is the investor.⁴³ Even larger businesses, such as YouStake or TastyStakes, could limit the number of investors in a given professional competitor's staking agreement to also escape state registration requirements. Given the small size of participants in the investment venture and the exemption under NRS § 90.530(11), it is therefore likely that a majority of staking agreements are exempt from state registration.

While staking agreements may escape registering with the state of Nevada, it is much less likely that they will escape federal registration requirements applied by the Securities and Exchange Commission.

III. FEDERAL LAW

Expanding beyond the often secretive staking agreements, YouStake, Inc. ("YouStake") developed an online platform to facilitate staking agreements between professional competitors and members of the public.⁴⁴ Launched in 2015, YouStake, Inc. sought to bring staking agreements into the open market and increase opportunities for athletic competitors and public investors.⁴⁵ A majority of the agreements hosted on YouStake's website are poker professionals seeking capital contributions, but YouStake's platform hosts staking agreements for other athletic activities, including golf, tennis, drone racing, eSports, and even mixed martial arts.⁴⁶

It wasn't long, however, before federal regulatory agencies began to examine the service that YouStake was facilitating. The United States Supreme Court has ruled that it is the responsibility and task of the Securities Exchange Commission ("SEC") and the federal courts to determine when an interest between two parties constitutes a security under the Securities and Exchange Act of 1933 ("Securities Act").⁴⁷ In April 2016, the SEC issued subpoenas to YouStake regarding the newly opened SEC investigation.⁴⁸ YouStake has since commenced litigation against the SEC claiming that another federal regulatory agency, the Financial Industry Regulatory Authority ("FINRA"), has assured

⁴³ See *Sigel v. McEvoy*, 707 P.2d 1145, 1145 (Nev. 1985).

⁴⁴ See *Learn All About YouStake*, YOUSAKE, <https://YouStake.com/about> (last visited May 15, 2019); Jackie M. Jensen, *Meet YouStake: Marketplace for Fans to Invest in Sports Players*, VEGASTECH (Feb. 7, 2016), <https://vegastech.com/2016/02/08/meet-youstake-invest-in-sports-players/>.

⁴⁵ *Id.*

⁴⁶ See *Find Players to Fund*, YOUSAKE, <https://YouStake.com/stake-a-player> (last visited May 15, 2019). See also *YouStake*, NETCAPITAL, netcapital.com/companies/youstake (last visited May 15, 2019).

⁴⁷ See *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 848 (1975).

⁴⁸ Complaint for Declaratory Judgment at 4, *YouStake, Inc. et al. v. Clayton et al.*, No. 5:17cv00065 (W.D. Va. July 7, 2017).

YouStake that the staking agreements they offer are not securities under current federal securities law.⁴⁹ On December 18, 2017 the SEC informed YouStake that it would not be recommending enforcement action against YouStake and that it does not currently consider YouStake's business model as offering securities.⁵⁰ The SEC likely used the test from *SEC v. W.J. Howey Co. et al.* (commonly known as the "Howey test") to determine whether YouStake's staking agreements constitute securities under the Securities Act.⁵¹ While the SEC ultimately did not recommend enforcement action against YouStake, it is likely that under the *Howey* test staking agreements are indeed investment contracts and therefore securities under the Securities Act.

A. "Security" Defined by the Securities and Exchange Act of 1933

Congress adopted the Securities Act for two primary purposes: to (1) provide investors with financial and other significant information concerning securities being offered for public sale, and (2) "prohibit deceit, misrepresentations, and other fraud in the sale of securities."⁵² In pertinent part, the Securities Act defined a "security" as follows:

The term "security" means any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, *certificate of interest or participation in any profit-sharing agreement*. . . *investment contract*. . . or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.⁵³

Since the enactment of the Securities Act, however, litigants before the United States Supreme Court have disputed interpretation of the Act's security definition and its application to uncommon contractual arrangements between two parties.⁵⁴ The United States Supreme Court's decision in one such case, commonly known as the *Howey* case, remains the cornerstone precedent in defining investment contracts under the Securities Act.⁵⁵

⁴⁹ *Id.* at 6–7 (FINRA asked YouStake to withdraw its application for the sale of a security stating that staking activity does not constitute a security under federal law, and that staking regulation was outside the scope of FINRA's regulatory authority.).

⁵⁰ *SEC Drops YouStake Investigation, Countering Action Dismissed*, FLUSHDRAW (Jan. 3, 2018), <http://www.flushdraw.net/misc/sec-drops-YouStake-investigation-countering-action-dismissed>.

⁵¹ See *SEC v. W. J. Howey Co. et al.*, 328 U.S. 293, 301 (1946); discussion *infra* Section III(b).

⁵² *The Laws That Govern the Securities Industry*, U.S. SEC. & EXCH. COMM'N (Oct. 1, 2013), <https://www.sec.gov/answers/about-lawsshtml.html>.

⁵³ Securities Act of 1933 § 2(a)(1), 15 U.S.C. § 77b(a)(1) (2012) (emphasis added).

⁵⁴ See, e.g., *Marine Bank v. Weaver*, 455 U.S. 551, 558–59 (1982); *Tcherepnin v. Knight*, 389 U.S. 332, 332–33 (1967); *W. J. Howey Co.*, 328 U.S. at 297.

⁵⁵ *Id.* at 293. See also James D. Gordon III, *Defining a Common Enterprise in*

B. The Howey Test

SEC v. W.J. Howey Co. et al. came before the United States Supreme Court shortly after adoption of the Securities Act in 1933.⁵⁶ In *Howey*, the court determined whether service contracts between a Florida citrus fruit cultivating company and individual leaseholders constituted a security under the Securities Act.⁵⁷ These service contracts allowed individuals to purchase ten-year leasehold interests in citrus grove acreage cultivated and managed by the W.J. Howey Company.⁵⁸ In assessing whether such service contracts constituted securities under the Securities Act, the court employed a four prong test:

[A]n investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promotor or third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise.⁵⁹

Today, the court's decision in *Howey* has produced four elements necessary for an offering to constitute a security: (1) An individual invests money, (2) in a common enterprise, (3) with the expectation of a profit, and (4) where the profit is realized through the efforts of someone else.⁶⁰ Additionally, the U.S. Supreme Court has held that an offering need not be of a common nature and that "[n]ovel, uncommon, or irregular devices" may be governed under the scope of the Securities Act.⁶¹ As the cornerstone case defining securities pursuant to the Securities Act, the SEC will likely use the *Howey* test to determine whether staking agreements are securities.

1. Howey Test Element One: "Individual Invests Money"

The first prong of the *Howey* test, namely whether an individual is investing money or capital, is likely met by the current common structures of staking agreements. While seemingly straightforward, litigants have contested this prong of the *Howey* test since its adoption. In 2009, the Ninth Circuit decided *Warfield v. Alaniz*, wherein financial planners convinced investors to make irrevocable charitable donations to a "charitable gift annuity" with the promise that the investor would receive back a lifelong stream of income that would proceed to a

Investment Contracts, 72 OHIO ST. L.J. 59, 65 (2011) ("The leading case regarding the definition of investment contracts is *SEC v. W.J. Howey Co.*").

⁵⁶ See *W. J. Howey Co.*, 328 U.S. at 293–294.

⁵⁷ *Id.* at 294–97.

⁵⁸ *Id.* at 295–96.

⁵⁹ *Id.* at 298–99.

⁶⁰ *Id.*

⁶¹ *SEC v. C. M. Joiner Leasing Corp. et al.*, 320 U.S. 344, 351 (1943).

charitable organization at the time of their death.⁶² The defendants in *Warfield* argued that the charitable gift annuities were not securities because the investors intended to make charitable donations rather than invest for financial gain, and thereby did not make any investment of money or capital.⁶³ The Court rejected this argument stating that the *Howey* test's first prong is met where an individual investor "commit[s] his assets to the enterprise in such a manner as to subject himself to financial loss."⁶⁴ The Court held that investors risked financial loss by investing in an enterprise that could possibly not honor its contractual promises.⁶⁵

Staking agreements likely fulfill the "investment of money" prong of the *Howey* test according to *Warfield's* financial loss test. Taking the staking agreement between Tom McEvoy and Martin Sigel as an example, Sigel funded McEvoy with the expectation of sharing in any award that McEvoy might win in the WSOP tournament.⁶⁶ The very nature of this expectation implies that Sigel was wholly aware that there existed a possibility McEvoy could lose the tournament. If McEvoy did lose and did not recover any award proceeds, then Sigel would collect neither any share of award proceeds, nor reimbursement from McEvoy for his initial capital investment. Sigel, therefore, risked financial loss by providing McEvoy with the initial funding to enter the WSOP tournament and likely fulfills the first prong of the *Howey* test.

2. *Howey Test Element Two: "In a Common Enterprise"*

After the U.S. Supreme Court defined an investment contract as requiring investment "in a common enterprise" (also known as the commonality requirement), the various circuit courts issued decisions that vary greatly in their definition of what constitutes a "common enterprise."⁶⁷ The resultant separate categories of the commonality requirement now include horizontal commonality, narrow vertical commonality, and broad vertical commonality.⁶⁸ Horizontal commonality is satisfied where an investor pools resources with other investors and the profits of the investors are dependent upon the overall success of the venture, whereas vertical commonality is satisfied where each individual investor's return is dependent upon the promoter/manager's efforts.⁶⁹ Vertical

⁶² See *Warfield v. Alaniz*, 569 F.3d 1015, 1018, 1020 (9th Cir. 2009). Sold from 1996 to 2001, these charitable gift annuity investment products were wildly popular. Unfortunately for the investors, the organization that offered this product was nothing more than a Ponzi scheme in which the organization used investor capital to pay off early annuitants and commission payments to financial planners. *Id.* at 1018.

⁶³ *Id.* at 1021.

⁶⁴ *Id.*

⁶⁵ *Id.*

⁶⁶ See *Sigel v. McEvoy*, 707 P.2d 1145, 1145 (Nev. 1985).

⁶⁷ Gordon, *supra* note 55, at 60–61, 68.

⁶⁸ *Id.* at 61–62.

⁶⁹ *Id.* at 66–67.

commonality is further bifurcated into narrow vertical commonality and broad vertical commonality, discussed in depth below. Ultimately, it is likely that staking agreements satisfy horizontal, narrow vertical and broad vertical commonality.

a. Horizontal Commonality

Currently, horizontal commonality is the categorical commonality requirement used by the Third, Sixth and Seventh Circuits; the Second Circuit accepts horizontal commonality but has not ruled on vertical commonality.⁷⁰ As described by the Seventh Circuit in *Wals v. Fox Hills Dev. Corp.*, horizontal commonality consists of “a pooling of interest[] not only between the . . . promoter and each individual ‘investor’ but also among the ‘investors’ . . .”⁷¹ This pooling often follows an agreed upon pro-rata basis for the distribution of profits.⁷² Furthermore, the profits returned to each investor are dependent upon the “profitability of the enterprise as a whole[.]”⁷³

Staking agreements likely fulfill both requirements of horizontal commonality, if the SEC or a federal court would use horizontal commonality as a basis for defining a “common enterprise.” Investors in staking agreements provide contributions to a pool of capital to permit the professional to participate in the activity the professional desires.⁷⁴ This is true if the staking agreement consists of one benefactor and one professional or, as is the case with businesses such as YouStake, multiple investors pooling resources to allow a professional to compete. Furthermore, the distribution of a professional’s award winnings often occurs on a pro-rata basis where there exist multiple investors, such as in the example of Scott Blumstein and his college friends.⁷⁵ Finally, any award proceeds distributed to a single or multiple investors is contingent upon the success of the professional, i.e. the profitability of the enterprise as a whole.⁷⁶ In other words, the resources that are pooled by a single or multiple investors allow the professional to compete with the goal of achieving large award winnings and achievement of that award results in profitability for each individual investor based upon a pro-rata share. Equally important for horizontal commonality, failure to achieve an award results in a loss to each individual investor, regardless

⁷⁰ *Id.* at 68. *See also* *Revak v. SEC Realty Corp.*, 18 F.3d 81, 88 (2d Cir. 1994); *Wals v. Fox Hills Dev. Corp.*, 24 F.3d 1016, 1017 (7th Cir. 1994); *Newmyer et al. v. Philatelic Leasing, Ltd. et al.*, 888 F.2d 385, 394 (6th Cir. 1989); *Salcer v. Merrill Lynch, Pierce, Fenner & Smith Inc. et al.*, 682 F.2d 459, 460 (3d Cir. 1982).

⁷¹ *Wals*, 24 F.3d at 1018.

⁷² *Revak*, 18 F.3d at 87.

⁷³ *Id.*

⁷⁴ *See* *Sigel v. McEvoy*, 707 P.2d 1145, 1146 (Nev. 1985). *See also* *Peters*, *supra* note 10.

⁷⁵ *Sofen*, *supra* note 2.

⁷⁶ *Revak*, 18 F.3d at 87.

of pro-rata share in the enterprise.⁷⁷ It is therefore likely that staking agreements would meet horizontal commonality and thereby the commonality requirement under the *Howey* test.

b. Broad Vertical Commonality

It is also likely that staking agreements would meet the broad vertical commonality requirement. Accepted and used by the Fifth and Eleventh Circuits to determine commonality, broad vertical commonality is met where the “investor’s fortunes are dependent on the manager’s managerial and entrepreneurial effort and skill in . . . producing income for the investor.”⁷⁸

The significant difference between broad and narrow commonality arises from the difference in *how* investors are dependent upon the managers of the enterprise. In *Long v. Shultz Cattle Co., Inc.*, the Fifth Circuit distinguished broad vertical commonality from narrow vertical commonality by stating that broad vertical commonality occurs where investors, as a collective, rely upon the manager’s expertise or skill for the return of a profit.⁷⁹ Similar in fashion to horizontal commonality, broad vertical commonality emphasizes the investors’ relationship to the manager as a collective, rather than on the individual relationship between the investor and the manager.⁸⁰ Narrow vertical commonality emphasizes this latter relationship, discussed in the next section.

While staking agreements likely meet the broad vertical commonality requirements, a federal court might rule otherwise due the effect luck or chance has upon a staking agreement’s return.⁸¹ On one hand, investors provide capital investment to professional competitors and rely upon their skill and expertise in their given competitive sport to receive a return upon investment. On the other hand, there does exist some amount of chance and/or luck involved when a professional player competes in their provided sport. Using poker as an example, however, it is more likely that poker professional skill determines future win/loss ratios.⁸²

Recent research conducted by Professor Steven D. Levitt and Dean Thomas J. Miles demonstrates that poker professionals perceived as skilled competitors have greater win/loss ratios and a greater return on investment when compared with non-skilled poker competitors.⁸³ In the study, Levitt and Miles compared

⁷⁷ *See id.*

⁷⁸ Gordon, *supra* note 55, at 68, 70. *See also* SEC v. ETS Payphones, Inc., 408 F.3d 727, 728 (11th Cir. 2005); Long v. Shultz Cattle Co., 881 F.2d 129, 133 (5th Cir. 1989).

⁷⁹ Long, 881 F.2d at 140–41.

⁸⁰ *Id.*

⁸¹ *See id.* at 140

⁸² *See* Steven D. Levitt & Thomas J. Miles, *The Role of Skill Versus Luck in Poker Evidence from the World Series of Poker*, 15 J. SPORTS ECON. 31, 41 (Feb. 2014).

⁸³ *Id.* at 38.

the win/loss ratios of 720 “high-skill” poker players to the win/loss ratios of 31,776 non-“high-skill” players at the World Series of Poker Tournament held in Las Vegas, Nevada.⁸⁴ The study also examined the differences of “high skill” and non-“high skill” player return-on-investment (“ROI”), determined by comparing buy-in amounts with dollars received in prize money.⁸⁵ Ultimately the study concluded that “high skill” players were “12 percent more likely to make . . . money than the average player, and 19 percent more likely to make the final table[,]” and that high-skilled players win approximately 54.9 percent of the match-ups throughout the tournament process.⁸⁶ The study also concluded that un-skilled players had an average ROI of approximately -15.6 percent,⁸⁷ while “high skilled” players had an ROI of 30.5 percent.⁸⁸

This study demonstrates that chance does play some role in the outcome of a professional’s ability to return a profit to a staking agreement investor, but that skill is the primary indicator of the likelihood that a staking agreement investor would receive a positive ROI.⁸⁹ It is therefore likely that broad vertical commonality is met by a staking agreement because a staking agreement investor primarily relies upon the skill of the competing professional for a positive ROI.

c. Narrow Vertical Commonality

It is additionally likely that a staking agreement would fit the criterion required by narrow vertical commonality because the profits of the professional competitor rise or fall with the profit of the investor(s) of a staking agreement. Currently the Ninth Circuit is the only circuit court that accepts narrow vertical commonality as fulfillment of the *Howey* test’s commonality requirement; the First, Second, Fourth and D.C. Circuits have not yet ruled on narrow commonality.⁹⁰ In *SEC v. Goldfield Deep Mines Co. of Nevada*, the Ninth Circuit defined a common enterprise as a “venture in which the fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment. . . .”⁹¹ Unlike broad vertical commonality, narrow vertical

⁸⁴ *Id.* (“High skill” players were determined according to six different proxies that included industry published rankings, past World Series of Poker “Main Event” champions, etc.).

⁸⁵ *Id.*

⁸⁶ *Id.* at 38, 41.

⁸⁷ *Id.* at 38 (A negative ROI indicated that an average player would lose money rather than receive any award amount over the initial buy-in investment).

⁸⁸ *Id.*

⁸⁹ *Id.* at 41.

⁹⁰ See *SEC v. SG Ltd.*, 265 F.3d 42, 50 (1st Cir. 2001); *SEC v. Banner Fund Int’l et al.*, 211 F.3d 602, 614 (D.C. Cir. 2000); *Teague v. Bakker*, 35 F.3d 978, 986 n.8 (4th Cir. 1994); *Revak v. SEC Realty Corp.*, 18 F.3d 81, 88 (2d Cir. 1994); *Hocking v. Dubois*, 885 F.2d 1449, 1459 (9th Cir. 1989) (en banc); *SEC v. Goldfield Deep Mines Co.*, 758 F.2d 459, 463 (9th Cir. 1985).

⁹¹ *Goldfield Deep Mines Co.*, 758 F.2d at 463 (quoting *Brodt v. Bache & Co.*, 595

commonality does not require a pooling of resource relationship to exist between investors to an enterprise. Instead, an enterprise is common under a theory of narrow vertical commonality where the profits of the manager of an enterprise rise and fall with the individual investor.⁹²

Application of the narrow vertical commonality test to staking agreements would result in staking agreements' fulfilling the *Howey* test's commonality requirement. The investors' pro-rata share of any profits rise and fall based upon the professional competitor's profits, i.e. award winnings, regardless of the size of the investor pool party to a staking agreement.⁹³ Both the investors party to a staking agreement and the professional competitor backed by the agreement receive no return if the professional fails to procure award winnings in his or her competition. Likewise, the backed professional that wins the grand prize shares a pro-rata share with the investors party to the staking agreement.⁹⁴ It is therefore likely that a court would find staking agreements meet the common enterprise requirement of the *Howey* test by way of narrow vertical commonality.

3. *Howey Test Element Three: "With the Expectation of a Profit"*

The U.S. Supreme Court in *Howey* additionally requires the investors in an offering to have a clear expectation of future profits for the offering to constitute an investment contract.⁹⁵ The U.S. Supreme Court defined the meaning of profits to include (1) "capital appreciation resulting from the development of the initial investment," or (2) "a participation in earnings resulting from the use of investors' funds."⁹⁶ An investment contract does not exist where the investor makes an investment with the intention to "use or consume" the purchased offering.⁹⁷

Investment contracts exist only where the expectation of profit is reasonable.⁹⁸ In *United Housing Foundation, Inc. v. Forman*, the U.S. Supreme Court considered whether the shares purchased in a cooperative housing project by residents constituted an investment contract.⁹⁹ In considering the residents' expectation of a profit, the Court determined that such an expectation was

F.2d 459, 460 (9th Cir. 1978)) (internal quotations omitted).

⁹² *See id.*

⁹³ *See generally* Albrecht, *supra* note 4; Peters, *supra* note 10.

⁹⁴ *See* Albrecht, *supra* note 4; Peters, *supra* note 10.

⁹⁵ SEC v. J. W. Howey Co., 328 U.S. 293, 298 (1946).

⁹⁶ *United Hous. Found., Inc. v. Forman*, 421 U.S. 837, 852 (1975). *See Tcherepnin v. Knight*, 389 U.S. 332, 338-339 (1967) (Investment contract where profits consisted of dividends off of saving and loan investments). *See also* SEC v. C.M. Joiner Leasing Corp. et al., 320 U.S. 344, 349 (1943) (Investment contract existed for sale of oil leases where conditioned on agreement to drill new well).

⁹⁷ *See United Hous. Found., Inc.*, 421 U.S. at 852-53.

⁹⁸ *Id.* at 852.

⁹⁹ *Id.* at 851.

unreasonable because any expectation of income was “far too speculative and insubstantial. . . .”¹⁰⁰

Staking agreements likely produce the characterization of “profits” required by an investment contract by virtue of the investor capital contributing to the participation of the professional in the contractually-agreed-upon competition. It is undeniable that the investor that backs a professional competitor does not expect his capital to appreciate in any meaningful manner, nor does the investor expect to use or consume the pro-rata share of award winnings provided by a staking agreement. Instead, the investor expects a profit to arise from the professional’s ability to provide a return through award winnings. The profits from a staking agreement are therefore likely to fulfill the *Forman* profit definition.¹⁰¹

The expectations of investors to a staking agreement are also likely reasonable. In *Forman*, the court emphasized that the expectation of the participants in the residential cooperative was consumption of living quarters for personal use and any expectation by a participant of a return based upon income from leasing various aspects of the building was “too speculative.”¹⁰² The emphasis, therefore, is on whether the expectation of the investor to receive income from an investment is speculative, rather than whether the investment itself is speculative.

An investor to a staking agreement has an expectation to receive income from an initial investment by means of a professional’s award winnings. This expectation is not speculative because the investor acknowledges, from the moment they enter into a staking agreement, that income will arise from the ability of the professional competitor to succeed in his or her competition. It is therefore likely that staking agreements fulfill the third element of the *Howey* test.

4. *Howey Test Element Four: “With that Profit to be Realized Through the Efforts of Someone Other than the Investor”*

Finally, the professional in a staking agreement is solely responsible for the realization of any ROI, inferring a strong likelihood that staking agreements meet the final prong of the *Howey* test. This final *Howey* element requires that an investment contract include profits produced “solely from the efforts of others.”¹⁰³ The Circuit Courts, while divided on the issue of commonality, accept the Ninth Circuit’s definition of “solely” as it applies to this final element of the

¹⁰⁰ *Id.* at 856 (Court rejects that income derived from leasing of “commercial facilities, professional offices and parking spaces, and. . .operation of community washing machines” constitutes profits reasonably expected).

¹⁰¹ *See id.* at 852.

¹⁰² *Id.* at 856.

¹⁰³ *SEC v. J. W. Howey Co.*, 328 U.S. 293, 301 (1946).

Howey test.¹⁰⁴ In *SEC v. Glenn W. Turner Enterprises, Inc.*, the Ninth Circuit determined that the Supreme Court's use of "solely" in the *Howey* test shall have a realistic connotation rather than a literal or strict connotation.¹⁰⁵ The Court reasoned that a strict interpretation of the definition of "solely" would preclude an offering from classification as an investment contract where the purchasing party contributes a "modicum of effort."¹⁰⁶ The Court instead emphasized that the measurement for this final element shall include a realistic test where "the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise."¹⁰⁷

Applying the Ninth Circuit's realistic test for "solely" to staking agreements reveals likely fulfillment of the final element of the *Howey* test. In the common model for staking agreements, the investor's contribution involves only the provision of capital to the professional competitor.¹⁰⁸ The professional competitor uses the capital to meet the necessary costs and expenses to enter into competitions that often have high participation fees.¹⁰⁹ The investor's ROI is entirely dependent upon the success or failure of the professional competitor or, as the *Turner* court states, the professional competitor is responsible for the "managerial efforts [that] affect the failure or success of the enterprise."¹¹⁰ It is therefore likely that staking agreements fulfill the final element of the *Howey* test.

C. Unusual Instruments: *Marine Bank v. Weaver*

Through an analysis of the Supreme Court's *Howey* test, it appears a court could logically define a common staking agreement as an investment contract. Staking agreements, however, must pass another test promulgated by the Supreme Court to receive classification as an investment contract. In *Marine Bank v. Weaver*, the Supreme Court considered whether certificates of deposit ("CD") sold by a federally regulated bank constituted a security under the Securities Exchange Act ("Securities Act").¹¹¹ In *Marine Bank*, the Court effectively narrowed the *Howey* test by permitting exceptions to uncommon and irregular instruments that are both unique and lack financial risk.¹¹² The Court

¹⁰⁴ See *SEC v. Glenn W. Turner Enters., Inc., et al.*, 474 F.2d 476, 481–482 (9th Cir. 1973).

¹⁰⁵ *Id.* at 482.

¹⁰⁶ *Id.*

¹⁰⁷ *Id.*

¹⁰⁸ See generally Huber, *supra* note 38.

¹⁰⁹ See generally Jon Sofen, *supra* note 2 (\$10,000 buy-in for the 2017 World Series of Poker Tournament in Las Vegas, Nevada).

¹¹⁰ *Turner*, 474 F.2d at 482 (9th Cir. 1973).

¹¹¹ *Marine Bank v. Weaver*, 455 U.S. 551, 552 (1982).

¹¹² *Id.* at 556.

examined the number of investors involved to determine whether an instrument was unique, and implied that the greater the number of potential investors, the more likely that an agreement is not unique.¹¹³ An agreement that contains only a single purchaser and seller/manager, however, is likely to be unique and outside congressional intent for regulation under the Securities Act.¹¹⁴ Additionally, an agreement whose product contains little to no risk is less likely to constitute an investment contract under the Securities Act.¹¹⁵ In *Marine Bank*, the Court held a CD was not a security because the CD was federally insured and therefore posed little-to-no financial risk for potential investors.¹¹⁶

It is likely that a court would determine a staking agreement to constitute an “uncommon or irregular instrument” as it is an agreement that falls outside the ordinary understanding and common definition of a security under the Securities Act.¹¹⁷ It is therefore likely that a court would apply the *Marine Bank* test to determine if a staking agreement constituted an investment contract. Depending on the circumstances, however, a staking agreement may or may not be unique. For example, the staking agreement between Mr. McEvoy and Mr. Sigel discussed *supra* Section II of this article is likely to be a unique agreement as defined by the *Marine Bank* test because the agreement is between only two parties.¹¹⁸ In contrast, YouStake’s staking agreement model is less likely to be defined as a unique agreement because it permits multiple potential investors to contribute capital to a competitor.¹¹⁹

Even if a court does find that a staking agreement constitutes a unique offering, it is less likely, if not impossible, that a court will decide that a staking agreement bears little to no risk. Using poker as an example, research indicates that a highly skilled player wins only 54.9% of their matches throughout a tournament.¹²⁰ When compared to a CD, a staking agreement has significantly more financial risk.¹²¹ Staking agreements, depending on the number of investors to the agreement, likely pass both the *Howey* test and the *Marine Bank* test. Despite passing both tests, it may be possible that federal exemptions to registration exempt staking agreements from registration with the SEC.

¹¹³ *Id.* at 559–560.

¹¹⁴ *See id.*

¹¹⁵ *Id.* at 558.

¹¹⁶ *Id.* at 559.

¹¹⁷ *See id.* at 556.

¹¹⁸ *See generally* Sigel v. McEvoy, 707 P.2d 1145, 1145–47 (Nev. 1985).

¹¹⁹ *See* Jensen, *supra* note 44.

¹²⁰ *See* Levitt & Miles, *supra* note 83, at 41.

¹²¹ *Compare Weaver*, 455 U.S. at 558–559 (a Certificate of Deposit has little to no risk of not providing a return to an investor because the instrument is federally insured), *with* Levitt & Miles, *supra* note 83, at 38–42 (a professional poker player has a 45.1% chance of losing a match).

D. Exemptions to Registration Under the Securities Act

As has been discussed, it is likely that a court would find staking agreements to constitute an investment contract after application of both the *Howey* and *Marine Bank* tests. Under ordinary circumstances this would require issuers of staking agreements to register with the SEC.¹²² Often the process to register as a security with the SEC is costly, requiring the preparation of multiple complex forms and documents, and registered securities issuers are further required to complete periodic filings, forcing registrants to bear additional, future costs.¹²³ Staking agreements may, however, qualify for registration exemptions to the Securities Act to avoid initial and periodic registration costs.

1. Private Placements Exemption

The first possible exemption includes transactions offered by an issuer that do not involve any offering to the public, often called the “private placement” exemption.¹²⁴ The Securities Act permits the exemption but neither it, nor the SEC, provide any further guidance to the limitations of the exemption.¹²⁵ Instead, the U.S. Supreme Court has interpreted the Securities Act exemption language to “turn on whether the particular class of persons affected need the protection of the Act.”¹²⁶ Overall, the various Circuit Courts seem to agree that factors that help to determine whether the class of persons affected needs the Securities Act’s protection include, but are not limited to: “the number of offerees[,]” their relationship to one another and the issuer, the offerees’ sophistication, the size of the offering, and “the manner of the offering.”¹²⁷

Staking agreements, dependent upon the type, may be likely to escape registration through the private placement exemption. The more private type of staking agreement, similar to the one that existed between Mr. Sigel and Mr. McEvoy, would likely escape the registration requirement.¹²⁸ First, Mr. Sigel was the sole offeree of the staking agreement, making it significantly smaller

¹²² See Securities Act of 1933 § 5(a), 15 U.S.C. § 77e (2012).

¹²³ See *Small Business and the SEC*, U.S. SEC. & EXCH. COMM’N (Feb. 27, 2014), <https://www.sec.gov/reportspubs/investor-publications/infosmallbusqasbsechtm.html#fsl> (These documents include preparation of Form S-1, a prospectus, and various other disclosure documents that provide investors with information required by the Securities Act of 1933).

¹²⁴ Securities Act of 1933 § 4(a)(2), 15 U.S.C. § 77d(a)(2) (2012).

¹²⁵ *Id.*

¹²⁶ *SEC v. Ralston Purina Co.*, 346 U.S. 119, 125 (1953).

¹²⁷ See *U.S. v. Arutunoff*, 1 F.3d 1112, 1118 (10th Cir. 1993); *W. Fed. Corp. v. Erickson*, 739 F.2d 1439, 1442 (9th Cir. 1984); *Cook v. Avien, Inc.*, 573 F.2d 685, 691 (1st Cir. 1978); *Doran v. Petroleum Mgmt. Corp.*, 545 F.2d 893, 904 (5th Cir. 1977).

¹²⁸ See *Sigel v. McEvoy*, 707 P.2d 1145 (Nev. 1985).

than almost every public offering.¹²⁹ Second, the agreement was likely made in a private setting between Mr. Sigel and Mr. McEvoy. Finally, Mr. Sigel, the offeree, likely had sufficient sophistication to understand the terms of the agreement and the risks of no return from the investment. Viewed collectively, these factors seem to demonstrate that staking agreements made between one professional and one investor would be exempt under the private placement exception to registration.

It is less clear that the staking agreements offered by entities like YouStake would be exempt under the private placement exception because of YouStake's business model. YouStake advertises and markets shares of staking agreements to the public at large.¹³⁰ Furthermore, because YouStake facilitates members of the general public to enter into staking agreements with professionals, the investors likely have no personal relationship with the professionals, in stark contrast with the personal relationship that existed between Mr. Sigel and Mr. McEvoy prior to their staking agreement.¹³¹ YouStake is also more likely to offer shares of a professional's award winnings to a greater number of offerees.¹³² YouStake allows participants to contribute as little as twenty dollars for a pro-rata share in a specific campaign, permitting a large number of smaller offerees to participate in an otherwise high capital campaign.¹³³

2. *Limited Offering Exemption*

Staking agreements produced both between two private parties and more public offerings (such as YouStake) might additionally find exemption under Rule 504 of the Securities Act. Rule 504 of Regulation D allows registrants an exemption where the registrant offers and sells no greater than \$5,000,000 of securities within a twelve-month period.¹³⁴ Additionally, a registrant that takes advantage of Rule 504 may not use "general solicitation and advertising" to promote the securities offered.¹³⁵ Certain states also permit Rule 504 registrants to solicit or advertise to "accredited investors," or sophisticated investors whose net worth exceeds \$1,000,000 or yearly income exceeds \$200,000 for the prior two years.¹³⁶

It again seems that a private agreement between two parties to a staking agreement, similar to the circumstances surrounding Mr. McEvoy's staking

¹²⁹ *Id.*

¹³⁰ *See Jensen, supra* note 44.

¹³¹ *See Sigel, 707 P.2d* at 1145 (where Sigel and McEvoy entered into an oral agreement signifying a more personal relationship).

¹³² *See Jensen, supra* note 44.

¹³³ *Learn All About YouStake, supra* note 44.

¹³⁴ Securities Act of 1933 § 3(b), 15 U.S.C. § 77c(b)(1) (2012); 17 C.F.R. § 230.504 (2018).

¹³⁵ *Id.*

¹³⁶ 17 C.F.R. § 230.501(a) (2018).

agreement, would likely find exemption under Rule 504. These private agreements often involve the investor contributing capital in an amount significantly less than the \$5,000,000 cap required by Rule 504.¹³⁷ If found to be an investment contract, however, Mr. McEvoy would still be required to file a Regulation D Form with the SEC to describe that the agreement fulfills the exemption under Rule 504.¹³⁸

It is also possible that a company with a business model similar to YouStake could find exemption under Rule 504 but that it would choose not to seek exemption. It is conceivable that YouStake could limit the amount of shares to staking agreements to \$5,000,000 or less. This, however, would not make sense for YouStake's business model for two major reasons.

First, YouStake has an interest in making as much profit as it can within the market and would likely choose to bear the costs of registration under the Securities Act rather than forgo profit growth. Second, even if YouStake did wish to limit its profit growth, choosing exemption under Rule 504 would prevent them from advertising their services to the general public. Furthermore, YouStake's business model, i.e. to get as many market participants as possible, would also make it unlikely that the business would choose to sell only to accredited investors.¹³⁹

3. *Intrastate Offering Exemption*

The Securities Act also provides registration exemption to businesses that seek to raise capital within a particular state.¹⁴⁰ Commonly referred to as the "intrastate offering" exemption, registrants may be exempt where the offering company is organized in the state where the offering is taking place, carries out most of its business within the state in which it is organized, and makes offers and sales solely to the residents of that state.¹⁴¹ Rule 147 provides objective standards that a company seeking to register under the intrastate exemption may use as guidance to satisfy the intrastate requirements.¹⁴² These factors include whether the company has been organized in the state in which it sells the securities, if the company's principal place of business is located within the state, and the company verifies the residency of the purchaser of any offerings through written representation.¹⁴³

A staking agreement between two individuals is more likely to meet his

¹³⁷ See Sofen, *supra* note 2 (illustrating, for example, that the cost for backed poker professionals to enter the World Series of Poker Tournament Main Event in Las Vegas, Nevada is \$10,000).

¹³⁸ 17 C.F.R. § 230.503(a) (2018).

¹³⁹ See generally Jensen, *supra* note 44.

¹⁴⁰ Securities Act of 1933 § 3(a)(11), 15 U.S.C. § 77c(a)(11) (2012).

¹⁴¹ *Id.*; 17 C.F.R. § 230.147 (2018).

¹⁴² 17 C.F.R. § 230.147 (2018).

¹⁴³ *Id.*

exemption than an agreement with a large firm such as Youstake. It is reasonable to suspect that a staking agreement between a single professional and a single investor is more likely to occur in a single state, which is also both parties' domiciled state. It is also possible, however, that even these small staking agreements could not fulfill the intrastate exemption because the competitions within which the professional participates may occur outside the residency state, or the investor may be from a different state than the professional.

A large company, such as YouStake, would likely not seek this exemption. YouStake's business model is more likely to succeed where it is able to offer pro-rata shares of a professional's awards to as many purchasers as possible. YouStake would not be able to meet its need for high volume investor participation where YouStake is limited to the state in which it was organized.

4. *Regulation A Offering Exemption*

The final exemption that may be available to participants in a staking agreement falls under Regulation A filing. Under Regulation A, a company offering securities may be exempt under either Tier 1 or Tier 2.¹⁴⁴ Tier 1 registration allows securities offerings that do not exceed \$20,000,000 in a twelve-month period, while Tier 2 registration permits securities offerings that do not exceed \$50,000,000.¹⁴⁵ Tier 2 registration further limits non-accredited investor investments to either ten percent of either annual income or net worth (whichever is greater) or ten percent of either annual revenue or net assets at fiscal year-end (whichever is greater).¹⁴⁶ Tier 1 registration has no such limitations.¹⁴⁷

Both small and large staking agreement models are likely to meet the requirements of Regulation A registration exemptions. Small staking agreements, like the agreement between Mr. McEvoy and Mr. Sigel, could likely file a Tier 1 Regulation A registration exemption because the capital necessary is significantly lower than \$20,000,000 for a twelve-month period.¹⁴⁸ A larger staking agreement model, such as the YouStake model, could likely use Tier 2 Regulation A registration exemption to its advantage. First, Tier 2 limits capital formation to \$50,000,000, a respectable amount for a private company like YouStake. Second, Tier 2 registration would still permit YouStake to sell to non-accredited investors without difficulty because YouStake allows investors to purchase shares at as little as twenty dollars per campaign, an amount

¹⁴⁴ 17 C.F.R. § 230.251 (2018).

¹⁴⁵ *Id.*

¹⁴⁶ *Id.*

¹⁴⁷ *Id.*

¹⁴⁸ See *Sigel v. McEvoy*, 707 P.2d 1145 (Nev. 1985) (where Sigel provided McEvoy with the capital necessary to enter into a tournament hosted by The Horseshoe in Nevada, an investment likely well below the \$20,000,000 cap as required by Tier 1, Regulation A).

significantly less than ten percent of most participants' annual income or net worth.¹⁴⁹

IV. COSTS ASSOCIATED WITH SEC REGISTRATION

Under the current federal regulatory regime, the SEC will likely eventually define staking agreements as an investment contract security and thereby require registration of the offering. As discussed in Section III(d)(i) of this article, more privately conducted staking agreements, such as the agreement between Mr. McEvoy and Mr. Sigel, will likely avoid registration under the private placement exemption. Staking agreements conducted on a more public, national level, such as YouStake's agreements, could find exemption under the Regulation A filing exemption.¹⁵⁰ Filing under Regulation A would allow YouStake to avoid increased regulatory costs, at the expense of other limitations such as a cap on securities offered in a twelve-month period (i.e. \$50,000,000) and supervision of non-accredited investors.¹⁵¹ To avoid these limitations YouStake may opt for registration with the SEC without any exemptions whatsoever.

Registration with the SEC would permit YouStake to raise a larger amount of capital through public offerings but would come at a greater cost. A study conducted by the United States Government Accountability Office ("GAO") in 2000 revealed that the cost of small business public offerings is on average ten percent of the required capital formation and larger business public offerings cost, on average, eight percent of the required capital formation.¹⁵² A smaller business attempting to raise \$25,000,000 of capital through a public offering spends \$2,300,000 on average to register with the SEC.¹⁵³ These costs include \$1,750,000 for underwriting discounts and commissions, \$200,000 in legal fees, and \$160,000 in accounting fees.¹⁵⁴ These costs, while a smaller proportion of the capital formation desired, will only increase for a larger business attempting to raise more than \$25,000,000. In addition to the large initial cost to register with the SEC, YouStake would bear the costs associated with registration with state securities departments,¹⁵⁵ as well as the costs of annual reporting required by the SEC.¹⁵⁶

¹⁴⁹ See *SEC v. W. J. Howey Co.*, 328 U.S. 293, 297–99 (1946) (noting that "security" and "investment contract" have been defined broadly).

¹⁵⁰ See discussion *supra* Section III(d)(iv).

¹⁵¹ See 17 C.F.R. § 230.251 (2018).

¹⁵² U.S. GOV'T ACCOUNTABILITY OFF., GAO/GGD-00-190, SMALL BUSINESS: EFFORTS TO FACILITATE EQUITY CAPITAL FORMATION 23 (Sept. 2000).

¹⁵³ *Id.*

¹⁵⁴ *Id.*

¹⁵⁵ See generally *SCOR Overview*, N. AM. SEC. ADM'RS ASS'N, <http://www.nasaa.org/industry-resources/corporation-finance/scor-overview/> (last visited May 15, 2019).

¹⁵⁶ See generally *Exchange Act Reporting and Registration*, SEC.GOV (last updated

Registration with the SEC also imposes an opportunity cost to businesses that need to conduct business immediately.¹⁵⁷ The average delay that businesses face between filing and raising capital is approximately 104 days for smaller public offerings (\$20,300,000) and 106 days for larger public offerings (\$198,800,000).¹⁵⁸ Professor C. Steven Bradford, Earl Dunlap Distinguished Professor of Law at the University of Nebraska-Lincoln College of Law, argues that these registration delays can adversely affect small business necessities, including quick time-to-market and the ability to quickly raise capital.¹⁵⁹ If YouStake decided to proceed with registration with the SEC absent any exemptions or Regulation A filings, these are the costs they would be forced to bear in their attempts to conduct further business.

V. CONCLUSION

Recently, the SEC staff from the Division of Enforcement notified YouStake that it was not recommending an enforcement action against YouStake.¹⁶⁰ According to a cursory analysis of staking agreements under the *Howey* and *Marine Bank* tests, however, staking agreements are likely investment contracts. A federal court would likely find that a staking agreement, in the words of the U.S. Supreme Court, is “a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party[.]”¹⁶¹ Furthermore, staking agreements do not likely find exemption from definition as a security under *Marine Bank* because, while they may or may not be unique offerings, they are often characterized by a large amount of risk offset by a large return.¹⁶²

Despite the likelihood that staking agreements will be deemed investment contracts, the small number of participating investors in most staking agreements will allow the parties to take advantage of both state and federal registration exemptions. Smaller, more private staking agreements, like the agreement disputed in *Sigel v. McEvoy*, likely qualify for state registration exemption due to the small number of investors, as well as federal registration exemption under

Oct. 24, 2018), <https://www.sec.gov/smallbusiness/goingpublic/exchangeactreporting>.

¹⁵⁷ C. Steven Bradford, *Crowdfunding and the Federal Securities Laws*, 2012 COLUM. BUS. L. REV. 1, 43 (2012).

¹⁵⁸ U.S. SEC. & EXCH. COMM’N, REPORT OF THE ADVISORY COMMITTEE ON THE CAPITAL FORMATION AND REGULATORY PROCESSES, App. A, tbl. 2 (July 24, 1996), <https://www.sec.gov/news/studies/capform.htm>.

¹⁵⁹ See Bradford, *supra* note 157, at 43.

¹⁶⁰ Mo Nuwwarah, *YouStake Clears Major Legal Hurdle as SEC Drops Investigation*, POKERNEWS (Jan. 10, 2018), <https://www.pokernews.com/news/2018/01/youstake-sec-drops-investigation-29684.htm>.

¹⁶¹ SEC v. W. J. Howey Co., 328 U.S. 293, 298–99 (1946).

¹⁶² See *Marine Bank v. Weaver*, 455 U.S. 551, 558–60 (1982).

the private placements exemption.¹⁶³ Larger, more public staking agreements, like YouStake's business model, would have more difficulty qualifying for registration exemptions under state and federal law due to the necessity to advertise and the larger number of investors able to participate in a facilitated staking agreement. Finally, where larger staking agreements do not qualify for registration exemption, the average registration costs can rise to the level of eight to ten percent of desired capital formation, a hefty and possibly burdensome cost.¹⁶⁴

¹⁶³ See *Sigel v. McEvoy*, 707 P.2d. 1145, 1145 (Nev. 1985).

¹⁶⁴ See U.S. GOV'T ACCOUNTABILITY OFF., *supra* note 152.