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Sports betting in the United States - Lessons from Australia in connection with licensing of sports betting

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Overview

On 14 May 2018, the United States Supreme Court ruled in *Murphy*[1] that the Professional and Amateur Sports Protection Act 1992 (**PASPA**) was unconstitutional. The effect of the decision in *Murphy* is that each state of the United States is able to introduce laws to enable sports betting to be conducted lawfully. This provides a significant opportunity for the global gambling sector.

This paper does not purport to comment on the effect of the invalidity of PASPA and whether it will result in the legal availability of sports betting throughout the United States. That is best done by US legal commentators: this paper comments on the imminent issues that each US State will need to consider before implementing a regulatory framework for sports betting, taking into account the precedent that occurred in Australia following the liberalisation of sports betting in this country, also as a result of a court decision.

The *Murphy* case

In the *Murphy* case, the National Collegiate Athletic Association (**NCAA**) challenged a law introduced in New Jersey in 2014 which repealed a New Jersey statutory prohibition on sports gambling and authorised the placement of bets on sporting events at horseracing tracks and casinos in Atlantic City.[2]

NCAA argued that the New Jersey law was in breach of PASPA.

PASPA made it unlawful for a US State to *"sponsor, operate, advertise, promote, license, or authorise by law or compact… a lottery, sweepstake, or other betting, gambling or wagering*

scheme"[3] in connection with amateur or professional competitive sporting events, except in respect of activities covered by specific exemptions.

New Jersey challenged the validity of PASPA, on the basis that a specific prohibition in PASPA on the authorisation and licensing of sports gambling by a US State was inconsistent with the Tenth Amendment of the United States Constitution.

The Tenth Amendment of the United States Constitution, in essence, states that, where the Constitution itself does not delegate power to the United States Federal government, or takes power away from the States, that power is reserved to the States.

Ultimately, the United States Supreme Court held that PASPA dictates unequivocally what a State legislature was both permitted and prohibited to do. Accordingly, the Court ruled in favour of New Jersey and accepted its argument that the United States Congress is not empowered to dictate matters to State legislatures[4].

Due to the prohibitions in PASPA, there has been very limited sports betting conducted legally in the United States, as most legal sports betting was catered for by exceptions in PASPA (for example, pre-existing licensed sports betting that had been conducted prior to its introduction). Among the limited exceptions that existed are the legal sports betting sector in Nevada, totalisator operations conducted at various horse tracks as well as the limited ability in a few States to conduct betting via lottery-style parlay cards. However, from a general perspective, most sports betting engaged by US residents has taken place with unauthorised operators.[5]

The Murphy case and the recognition of legal sports betting (that was limited previously) is not new! Betfair v Western Australia (the Betfair case) – the Australian precedent.

The *Betfair*[6] case was a watershed in Australian law in respect of the constitutionality (and enforceability) of legislative restrictions relating to the conduct of sports betting.

In the *Betfair* case, Betfair Pty Ltd (**Betfair**) challenged the constitutionality of a statute in Western Australia which sought to prohibit sports betting operators licensed in another Australian state from providing betting exchange services in Western Australia. Betfair argued that the Western Australian statute was in breach of Australian constitutional law, as the legislation discriminated between Betfair (an operator licensed in another Australian State) and Western Australian licensed betting operators.

The High Court of Australia (Australia's highest court – the equivalent of the US Supreme

Court) accepted Betfair's argument, concluding that such discrimination was protectionist, and not reasonably appropriate and adapted to achieving a legitimate purpose.

Accordingly, the relevant statutory prohibition was held to be unconstitutional.

Although the arguments accepted by the Court in each of *Betfair* and *Murphy* were different, both cases resulted in prohibitionist laws relating to sports betting being declared invalid and the potential in each country for the expansion of the legal sports betting sector.

In effect, the *Betfair* case liberalised the Australian betting sector as it recognised the entitlement of any betting operator licensed in an Australian jurisdiction to provide services to customers located throughout Australia. Subsequently, it was clarified that those licensed operators could promote those services throughout Australia: this resulted in an explosion in betting advertising throughout the country on all media.

Similarly, commentators in the United States have suggested that the Supreme Court's decision in the *Murphy* case will revolutionise the American gambling industry by providing unprecedented opportunities for sports betting operators to seek licences in the United States and provide services legally on this basis.

This is clear from the many operators and other stakeholders, particularly international operators, which are openly preparing to pursue those opportunities as they arise.

This is not a dissimilar position to Australia following the Betfair decision in 2008, almost a decade ago. Following the decision, the Australian gambling industry expanded quickly as major European operators, such as Paddy Power Betfair (Sportsbet), William Hill (now acquired by TSG), bet365, Kindred (Unibet) and Ladbrokes all entered the Australian market.

So, what's next?

For those US States that decide it is appropriate to introduce a legal framework to enable sports betting to be licensed, the policy decision to do so is easy: there are many other issues that will need to be addressed. It is the manner in which the relevant legal framework is implemented that will pose a challenge.

One of the most important considerations for each US State will be how its laws will interact with the laws of other US States that have introduced or propose to introduce a regulated framework for sports betting. While many issues (such as taxation) can be dealt with on a state

level, the licensing regime applicable to sports betting will give rise to a myriad of issues in the context of interstate sports betting. It is essential that US States ensure that the differing requirements that apply will not, in aggregate, make it too onerous for sports betting operators to conduct a viable business. This is more likely where overlapping and inconsistent laws are introduced.

It is also important for each US State to understand that there are various stakeholders to be considered when introducing a regulatory regime for sports betting, and that each of those stakeholders has different interests and perceptions of how the regulatory regime should apply. Many of these stakeholders will have conflicting views as to the obligations that should be imposed on licensed sports betting operators, including the taxes and other financial imposts that should apply. In our experience, these obligations are often burdensome, inconsistent and are not considered in a "whole of industry" context.

It must be remembered that one of the objectives in enabling licences to be granted is for a legal sports betting sector to be formed – the regulatory regime that is put in place must seek to ensure that a financially stable legal sports betting sector exists for the benefit of American consumers.

On the other hand, the relevant US State will need to keep in mind the interests of any existing stakeholders who have the right to conduct sports betting, particularly if they involve some element of exclusivity. To what extent should those exclusive rights holders be protected? Do they have a statutory or contractual right that must be retained? Will new entrants have the same or different rights? Does this give rise to potential further legal conflict against the State/between the rights holders?

How will each State regulate sports betting?

Each US State will need to consider whether (and, if so, how) betting operators will be licensed.

This poses a further question, namely, the extent to which (if at all) recognition will be given in any US State to the licensing regime that exists in another US State.

Additionally, there remains the uncertainty as to whether a betting operator licensed in a jurisdiction outside the United States will be permitted to provide sports betting services to customers located in a US State that permits sports betting, and to what extent recognition will be given to the licensing regime under which it conducts its business. This might include the consideration of compacts under which sports betting risks and liquidity might be shared.

The necessity for some form of recognition to be given by one jurisdiction to the standards of another jurisdiction has been recognised in the gambling sector internationally for many years. Examples include Australia's national model in the 1990s, which enabled one state to recognise other states' licensing regimes and contemplated the sharing of gambling taxes and the enactment of laws in various European countries which enables the sharing of liquidity of online poker operators across different countries.

Similarly, consideration of this issue is required in connection with the licensing of sports betting, for example, the standards and conditions that should be applied. Among the issues requiring consideration by each US State are:

- Must there be an office in the State?
- Where must the systems infrastructure be located (noting that many betting operators are now hosted in the cloud)?
- What systems infrastructure must be located in the State?
- Will separate security be required?
- What employees must be located and/or what business must be conducted in the State?
- Will each State have its own technical specifications?
- What probity inquiries will be conducted by a State in relation to the applicant, its stakeholders, ultimate beneficial owners and its personnel?
- Will recognition be given to probity inquiries conducted elsewhere? In another State/overseas?
- What integrity measures will apply and what fees should be paid to sporting leagues to enhance integrity measures?
- What events/contingencies will be permitted?

In looking at these issues, one factor more than any other factor will affect the manner in which the licensed sports betting market develops in the United States. Will recognition be given by a US State in respect of any, or all, of the above, elements in the licensing process conducted in another US State?

To the extent that there is duplication or inconsistent standards, where the licensing regime involves each US State having a separate licensing regime, there will be higher, and potentially significantly higher, costs, time delays and barriers to entry. This would mean, first, that only the largest operators with the greatest financial backing will be able to apply for licences on a multi-state basis and, secondly, that overseas unlicensed operators will remain the only manner in which many Americans will place sports bets.

The Australian gambling industry faced similar questions.

In the *Betfair* case, it was held that, to the extent that a gambling service is provided legally under a licence granted in any Australian State or Territory, that gambling service would be recognised as a legal service under the laws of the other States and Territories, subject to restrictions in the laws of the other States or Territories. However, those restrictions only apply to the extent that they are not protectionist and operate only on a non-discriminatory basis.[7]

Further, where specific regulatory requirements exist in various US States, the regulatory burden that will result will be so significant that very few betting operators will be able to operate nationally. Also, the costs of compliance will be so substantial that the capability of licensed United States operators to compete with offshore operators will be diminished.

How will each US State tax sports betting?

Each US State will need to consider whether sports betting operators will be taxed by the US State in which the operator is licensed (point of supply), and/or the US State in which customers are permitted to place bets (point of consumption).

It may be the case that an operator will be taxed at both the point of supply and the point of consumption. Will there be any sharing of tax collected in one US State (the point of supply) with other States where bets are placed (the point of consumption)?

In Australia, currently, States are introducing point of consumption taxes (at various rates of up to 15% of gross gambling revenue) which is in addition to tax imposed at the point of supply (10% of gross gambling revenue).

These gambling taxes are in addition to other taxes and imposts (such as product fees – see below). For example, in Australia, betting operators are subject to income tax (like any business) as well as GST, Australia's indirect sales tax. GST is applied to the margin of betting operators in accordance with a specific tax ruling.

Similarly, the United States will need to address the interaction between gambling taxes (i.e. a point of consumption or supply tax, if any) and other taxes that may be applicable.

How will consumers be protected?

An important consideration for each US State will be how to ensure, with the assistance of sports

betting operators, that the sports betting sector will be regulated in a way that minimises problem gambling for individuals.

States will often implement measures to target problem gambling that are specific to that State. This will result in the harm minimisation controls differing from state to state, with some States having additional or more stringent measures than other States.

This has occurred in Australia, with some States having much more detailed obligations than other States. As a result, some licensed betting operators have taken the view that the level of regulation in one State, at least, is too onerous and that the appropriate response is not to provide betting services to customers in that State.

This results in less competition in betting services being provided to residents of that State which, on the other hand, could result in customers in that State being more attracted to the services of offshore betting operators.

This difficulty was recognised in Australia, when the Federal Government in 2017 announced the introduction of a National Consumer Protection Framework (**NCPF**).[8] The NCPF sets out eleven harm minimisation measures to be implemented and met on a national basis by betting operators licensed in Australia. The NCPF comprises, amongst others, the following measures:

- A national self-exclusion register for online betting – this facilitates the exclusion of an individual from accessing the services of multiple online betting operators through a single, centralised application process;
- A voluntary, opt-out pre-commitment scheme for online betting – this imposes an obligation on licensed betting operators to offer each of their customers the opportunity to set pre-commitment limits to help control their betting activities;
- A prohibition on the offer of lines of credit by online betting providers – this imposes an outright ban on licensed betting operators making available any form of credit betting to their customers;
- A reasonable customer verification period to mitigate the risks associated with money laundering and terrorist financing, as well as preventing children under the age of 18 from opening a betting account and participating in betting activities; and
- A nationally consistent approach to the regulation of gambling advertisements in respect of online betting operators to ensure that all betting advertising includes a nationally consistent responsible gambling message and a single national gambling helpline.

How will sports betting operators be permitted to advertise?

What general restrictions should be in place?

Each US State will need to consider the appropriate balance between the right of the licensed betting operator to market their product, and the necessity for the operator to meet the general public's standards and expectations relating to sports betting advertising. Of equal importance for US States will be the existence of consistency in gambling advertising regulation, as regulation on a state level may give rise to inconsistent and overlapping requirements from one US State to another.

In Australia, each Australian State and Territory has its own laws which regulate the promotion of betting services to customers in that jurisdiction. The Australian laws surrounding gambling advertising are complex, and differ from state to state. Indeed, many state laws overlap to impose obligations on betting operators to ensure (amongst others):

- a responsible gambling message is included in all betting advertising; and
- betting advertising materials do not, among other things:
    - offer customers an inducement to participate in betting activity;
    - depict or target children under the age of 18;
    - make false, misleading or deceptive representations; or promote the consumption of alcohol while participating in betting activity.

What restrictions on inducements should be in place?

In Australia, betting operators are subject to an array of restrictions in respect of the promotion of their services, particularly in regards to offering customers an inducement to bet (or to open a betting account). The level of restrictions imposed on betting operators differ from State to State and it was one of the objectives of the NCPF to implement consistent requirements on a national basis. This has not yet occurred.

Indeed, New South Wales (Australia's most populous state) has introduced the most stringent measures relating to betting advertising that exists in Australia. This includes prohibitions on the promotion of inducements, and in particular, the requirement that no person in New South Wales must be able to **view** an inducement to engage in betting activity. As a result, Australian licensed betting operators and intermediaries (such as affiliates and media platforms) must install geo-targeting software to ensure that offending promotions cannot be viewed by people in New South Wales.

It is a real risk that US States will perceive the necessity to implement restrictions that are considered specific to that State (and different from other US States) to protect fully their residents from harm associated with sports betting and sports betting advertising.

Without appropriate controls, there is likely to be significant advertising by licensed sports betting operators throughout the United States.

On the other hand, controls along the line of those introduced in New South Wales will result in significant restrictions that are complex, costly and sometimes impractical to implement (many of which differ between States) leading to an inconsistent and disjointed regulatory approach.

Protection of Integrity in Sports

In Australia, the sports betting industry is regulated in a manner that results in the sporting sector enjoying part of the financial benefits associated with betting on the sport. This is achieved by imposing an obligation on licensed betting operators to pay product fees to Australian racing and sporting bodies for the use of race fields and sporting information. These obligations are imposed by laws at the state level which, in general terms, confer on a racing or sporting body a monopoly. This monopoly allows the relevant racing or sports body to grant approval to betting operators to take bets on events conducted in that State under the control of that body. (In the absence of approval, bets cannot be taken on events/contingencies controlled by that racing or sports body.)

It is important to note that these arrangements exist as a result of the background to the Australian betting sector. These circumstances will not necessarily be relevant in the United States.

In Australia, the relevant approval is granted generally under the terms of an agreement and is referred to as either a product fee and integrity agreement or, in one case, an integrity and product fee agreement. Under this agreement, the betting operator is required to pay a fee (up to 4% of betting turnover[9]) and meet integrity controls imposed by that body.

In order to hold the right to grant these approvals, the relevant body is required to demonstrate that it has appropriate integrity controls and, in some States, that it complies with specified legislative conditions.

Further, most Australian States have specific legislation targeting match fixing. This prohibits conduct, including betting transactions, which seek to influence the outcome of matches or contingencies that occur in those matches.

This complex regime has taken many years to develop – and it is still being refined – with

changes occurring in the manner of calculation of the fees, the fees being imposed and the restrictions on the manner in which betting can be conducted by licensed betting operators.

The key lesson from the Australian perspective is that very careful consideration is required to be given to the manner in which integrity controls are imposed and the existence and calculation of any integrity/product fee arrangement.

Although all stakeholders agree that sports integrity is fundamental, and a cornerstone of a successful sport, there is a real risk that this objective can be compromised through regulatory controls relating to integrity (including match fixing) being imposed inconsistently at a state level unless implemented in a harmonised and cooperative manner.

Conclusion

Australia and the United States have many cultural and political similarities – both countries have a deep appreciation of sports, love to bet on their outcomes and have a Federal system. Both political systems recognise that States have the inherent right to regulate gambling including sports betting.

With the result of the *Murphy* case, the United States is in a similar position to that faced in Australia a decade ago in respect of the licensing of sports betting. Many issues, include those highlighted in this paper, will need to be taken into account and it is to be hoped that they are addressed in a manner which results in a consistent and transparent licensing framework that protects American consumers, sports and other stakeholders from offshore betting operators by enabling licensed betting operators to provide betting services with appropriate controls in place.

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1. *Murphy v. National Collegiate Athletic Association* (2018).
2. The law did not repeal the prohibition on sports gambling relating to New Jersey-based college sports.
3. *Professional and Amateur Sports Protection Act* 1992, 28 U.S.C. § 3702.

4. While this was a chance for the US Supreme Court to reconsider more fully the distribution of power between the Federal and State legislature, the Supreme Court concluded the decision by summarising as follows: *"The legalization of sports gambling requires an important policy choice, but the choice is not ours to make. Congress can regulate sports gambling directly, but if it elects not to do so, each State is free to act on its own. Our job is to interpret the law Congress has enacted and decide whether it is consistent with the Constitution. PASPA is not. PASPA "regulate[s] state governments' regulation" of their citizens…. The Constitution gives Congress no such power.""* 584 U.S. 31 (2018).
5. According to the American Gaming Association, *"[t]oday, at least $150 billion a year is*

wagered illegally on sports betting in the United States." Further, a report released in September 2016 concluded that, *"rather than setting the standard, the United States is on par with Russia and China, having forced a groundswell of black-market gambling by prohibiting the popular pastime of sports betting."*

6. *Betfair Pty Ltd & Anor v Western Australia* [2008] HCA 11.

7. A prohibition will be non-discriminatory if it applies to all operators of a particular service (irrespective of whether an operator is providing services to customers in that particular State or Territory or providing services from that State or Territory to customers in another State or Territory).

8. For further information on the NCPF, please see our Focus Papers: A National Consumer Protection Framework for Australian Online Licensed Wagering Operators: Proposed Changes and The National Consumer Protection Framework: An analysis of the regulatory impact statement and its effect on Australian online wagering.

9. These fees, when aggregated with other fees and taxes payable by licensed betting operators, results in a significant percentage of betting revenue being payable.