

## Interests in Pooled Investment Entities, Such as Sports Betting Funds, Likely Constitute Securities

On Sept. 10, the Securities and Exchange Commission (“SEC”) announced the filing of settlement enforcement actions against two Nevada sports betting funds alleging that the funds had violated the registration requirements of the Securities Act of 1933, as amended (the “Securities Act”), by selling investments in the funds on the internet<sup>1</sup>. These enforcement actions serve as a reminder that interests in pooled investment entities likely constitute securities and that entities pooling investment capital must make sure that capital-raising activities are conducted in compliance with applicable securities laws.

The two funds in question operated under a 2015 Nevada law that allows entities to solicit and collect funds from individual investors anywhere in the world, aggregate those funds, place wagers on certain sporting events and split the wagering profits among the investors. Each of the SEC’s complaints alleges that the applicable fund raised capital by generally soliciting investors on the internet without making a determination whether all investors were accredited and that this conduct violated the registration provisions of the Securities Act. Each of the funds settled with the SEC, without admitting or denying the SEC’s findings, and consented to the entry of a judgment ordering a permanent injunction against future violations of Section 5(a) and Section 5(c) of the Securities Act and requiring each to send a copy of the final judgment to each investor. Notably, the funds were not required to pay disgorgement or civil penalties.

Whether interests in pooled investment entities constitute securities is a common question. If they are securities, the offer and sale thereof must be registered with the SEC under the Securities Act or made under an exemption from the Securities Act’s registration requirements (and applicable state law). Failure to comply may trigger, among other consequences, rescission rights, damages and civil and criminal penalties. For more background on the issue, click [here](#) and [here](#) to read our insights on LLC interests as securities and [here](#) related to investments under the EB-5 program as securities.

The funds in question sold limited liability company interests and limited partnership interests, respectively. These two types of interests are not expressly covered by the Securities Act definition of “security” and the SEC and courts instead analyze whether such interests constitute “investment contracts” under the definition. In doing so, the SEC and courts apply the test laid out in *SEC v. W.J. Howey Co.*, 328 US 293, 298-99 (1946) and its progeny. An investment meeting the four prongs of the so-called Howey test is an investment contract and therefore a security: (i) an investment of money, (ii) in a common enterprise, (iii) with a reasonable expectation of profits, (iv) that are derived from the efforts of others. The SEC and courts will examine the facts and circumstances and the “economic realities” of an instrument or arrangement as opposed to the form or labels.

For a variety of reasons, including the compliance obligations imposed on sports books that accept wagers from these funds, entity wagering has never gained much traction in the gaming industry. While these enforcement actions do not break new legal ground, they do serve as a reminder to seek legal counsel before setting up pooled investment entities.

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<sup>1</sup>*Securities and Exchange Commission v. Contrarian Investments, LLC, No. 02:18-CV-01725 (D. Nev.) filed September 7, 2018*

*Securities and Exchange Commission v. Nevada Sports Investment Group, LP, No. 02:18-CV-01726 (D. Nev.) filed September 7, 2018*

*This document is intended to provide you with general information regarding whether pooled investment entities constitute securities. The contents of this document are not intended to provide specific legal advice. If you have any questions about the contents of this document or if you need legal advice as to an issue, please contact the attorneys listed or your regular Brownstein Hyatt Farber Schreck, LLP attorney. This communication may be considered advertising in some jurisdictions.*