

**IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA**

KALSHIEX LLC,

Plaintiff,

v.

COMMODITY FUTURES TRADING
COMMISSION,

Defendant.

No. 23-cv-03257-JMC

Joint Appendix under Rule 7(n)
Volume 1

**JOINT APPENDIX UNDER RULE 7(n)
VOLUME 1**

KALSHIEX LLC v. CFTC, No. 1:23-cv-03257-JMC**Index of Joint Appendix Pursuant to Local Civil Rule 7(n)**

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UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

In the Matter of the Certification by KalshiEX LLC of Derivatives Contracts with Respect to Political Control of the United States Senate and United States House of Representatives

ORDER

BACKGROUND

By a submission dated June 12, 2023 (the “Submission”), KalshiEX LLC (“Kalshi”), a designated contract market (“DCM”), filed a certification of congressional control political event contracts (the “Congressional Control Contracts”), pursuant to section 5c(c)(1) of the Commodity Exchange Act (“CEA”) and Commodity Futures Trading Commission (“CFTC” or “Commission”) Regulation 40.2. On June 23, 2023, the Commission commenced review of the Submission pursuant to Commission Regulation 40.11(c), because the Commission determined that the Submission comprised contracts that may involve, relate to, or reference an activity enumerated in Commission Regulation 40.11(a)(1) and CEA section 5c(c)(5)(C)(i). By letter dated June 23, 2023, the Commission informed Kalshi of its determination to commence review of the Congressional Control Contracts pursuant to Commission Regulation 40.11(c), and requested that Kalshi suspend the listing and trading of the Congressional Control Contracts during the pendency of the review period. In addition, on June 23, 2023, the Commission

opened a comment period to request public comments to assist the Commission's evaluation of the Submission. The public comment period ended on July 24, 2023.¹

The Congressional Control Contracts are cash-settled, binary (yes/no) contracts based on the question: "Will <chamber of Congress> be controlled by <party> for <term>?" Kalshi describes the Congressional Control Contracts as event contracts. The settlement values of the Congressional Control Contracts are determined by the party affiliation of the leader of the identified chamber of the United States Congress on the expiration date. In the case of the House of Representatives, the leader is the Speaker of the House ("Speaker"), and in the case of the Senate, the leader is the President Pro Tempore ("Pres Pro Temp"). Upon settlement, an absolute amount is paid to the holder of one side of the contract, and no payment is made to the counterparty. All contracts trading on Kalshi are fully-collateralized.

The Congressional Control Contracts have a notional value of one dollar with a minimum price fluctuation of \$0.01, and must be purchased in multiples of 5,000 contracts per order. The Congressional Control Contracts have tiered position limits, depending on the category of market participant and whether that market participant has "demonstrated established economic hedging need," which may be demonstrated to Kalshi according to means and methods established by Kalshi.

The terms of the Congressional Control Contracts prohibit certain individuals and entities from trading the contracts, namely: 1) candidates for federal or statewide public office; 2) paid campaign staffers on Congressional campaigns; 3) paid employees of Democratic and Republican Party organizations; 4) paid employees of political action committees ("PACs") and

¹ The Commission received 1,378 comments, including four comments that were received after the close of the public comment period but were added to the comment file. *See* <https://comments.cftc.gov/PublicComments/CommentList.aspx?id=7394>.

“Super PACs” (independent expenditure only political committees); 5) paid employees of major polling organizations; 6) existing members of Congress; 7) existing paid staffers of members of Congress; 8) household members and immediate family members of any of the above; and 9) “any of the above listed institutions themselves.”

LEGAL STANDARD

Under CEA section 5c(c)(5)(C)(i), the Commission may determine that contracts in certain excluded commodities, as defined in CEA section 1a(19), are contrary to the public interest if the contracts involve: (1) activity that is unlawful under any Federal or State law; (2) terrorism; (3) assassination; (4) war; (5) gaming; or (6) other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.²

CEA section 5c(c)(5)(C)(ii) provides that “[n]o . . . contract . . . determined by the Commission to be contrary to the public interest under [CEA section 5c(c)(5)(C)(i)] may be listed or made available for clearing or trading on or through a registered entity[,]” including a DCM (such as Kalshi).³

Commission Regulation 40.11(a)(1) provides that registered entities, including DCMs, “shall not list for trading or accept for clearing” any contract based upon an excluded commodity, as defined in CEA section 1a(19)(iv), that “involves, relates to, or references terrorism, assassination, war, gaming, or an activity that is unlawful under any State or Federal law. . . .”⁴ Commission Regulation 40.11(a)(2) further provides that registered entities, including DCMs, “shall not list for trading or accept for clearing” any contract based upon an excluded

² CEA section 5c(c)(5)(C)(i); 7 U.S.C. § 7a-2(c)(5)(C)(i).

³ CEA section 5c(c)(5)(C)(ii); 7 U.S.C. § 7a-2(c)(5)(C)(ii).

⁴ 17 C.F.R. §§ 40.11(a)-(a)(1).

commodity, as defined in CEA section 1a(19)(iv), that “involves, relates to, or references an activity that is similar to an activity enumerated in [Commission Regulation] 40.11(a)(1) ... and that the Commission determines, by rule or regulation, to be contrary to the public interest.”⁵

Under Commission Regulation 40.11(c), when a contract that is submitted to the Commission by a registered entity, pursuant to Commission Regulation 40.2 or Commission Regulation 40.3, is based upon an excluded commodity, as defined in CEA section 1a(19)(iv), “which may involve, relate to, or reference” an activity enumerated in Commission Regulation 40.11(a)(1) or Commission Regulation 40.11(a)(2), the Commission is authorized to commence a 90-day review of the contract.⁶ Commission Regulation 40.11(c)(1) requires the Commission to request that the registered entity suspend the listing or trading of such contract during the 90-day review period.⁷ The Commission must ultimately issue an order approving or disapproving such contract by the end of its review or at the end of any extended period agreed to or requested by the registered entity.⁸

⁵ 17 C.F.R. §§ 40.11(a)-(a)(2).

⁶ 17 C.F.R. § 40.11(c).

⁷ 17 C.F.R. § 40.11(c)(1).

⁸ 17 C.F.R. § 40.11(c)(2).

FINDINGS

Having reviewed the complete record in this matter, including the Submission and the public comments received, the Commission makes the following findings and determinations pursuant to CEA section 5c(c)(5)(C) and Commission Regulation 40.11:

The Congressional Control Contracts Involve Enumerated Activities

WHEREAS, the Commission has evaluated whether the Congressional Control Contracts involve an activity enumerated in CEA section 5c(c)(5)(C)(i) and Commission Regulation 40.11(a)(1).

WHEREAS, the term “involve” is not defined for purposes of CEA section 5c(c)(5)(C)(i).

WHEREAS, an undefined term in a statute is generally given its ordinary meaning.⁹ To determine the ordinary meaning of undefined statutory terms, courts typically look to dictionary definitions for guidance.¹⁰

WHEREAS, definitions of the word “involve” include “to relate to or affect,” “to relate closely,” to “entail,” or to “have as an essential feature or consequence.”¹¹

⁹ See *Asgrow Seed Co. v. Winterboer*, 513 U.S. 179, 187, 115 S.Ct. 788 (1995); See also, *Morrisette v. United States*, 342 U.S. 246, 263, 72 S.Ct. 240 (1952) (holding that undefined statutory words that are not terms of art are given their ordinary meanings, frequently derived from the dictionary).

¹⁰ *Sanders v. Jackson*, 209 F.3d 998, 1000 (7th Cir. 2000).

¹¹ See *Involve Definition*, MERRIAM-WEBSTER, <https://www.merriam-webster.com/dictionary/involve> (last visited September 7, 2023); Random House College Dictionary 703 (Revised ed. 1979); Riverside University Dictionary 645 (1983); see also Roget’s International Thesaurus 1040 (7th ed. 2010) (giving as synonyms “entail” and “relate to”).

WHEREAS, the Commission has considered assertions by Kalshi and some commenters that, under CEA section 5c(c)(5)(C)(i), contracts “involve” an enumerated activity only if that activity is the contract’s underlying.

WHEREAS, when the CEA refers to a contract’s underlying, it uses the word “underlying,”¹² or it refers to what the contract is “based on”¹³ or “based upon.”¹⁴

WHEREAS, CEA section 5c(c)(5)(C)(i) itself uses “based upon” to refer to the underlying: it applies with respect to “contracts ... in [certain] excluded commodities that are *based upon* the occurrence, extent of an occurrence, or contingency” (emphasis added).¹⁵ The underlying must therefore be a kind of excluded commodity, but that is all that CEA section 5c(c)(5)(C)(i) says about the underlying.

WHEREAS, in CEA section 5c(c)(5)(C)(i), the requirement that the contract “involve” an enumerated activity is separate:

In connection with the listing of ... *contracts ... in excluded commodities that are based upon the occurrence, extent of an occurrence, or contingency* ... the Commission may determine that *such ... contracts ...* are contrary to the public interest *if the ... contracts ... involve* [an enumerated activity] (emphasis added).¹⁶

WHEREAS, in context, “based upon” and “involve” have different meanings for purposes of CEA section 5c(c)(5)(C)(i): “based upon” refers to the contract’s underlying (as it does elsewhere in the CEA), and “involve” refers to the enumerated activities and retains its broader ordinary meaning. In other words, the contract must be “based upon” a type of excluded

¹² *E.g.*, 7 U.S.C. §§ 6c(d)(2)(A)(i), 20(e), 25(a)(1)(D)(ii).

¹³ *E.g.*, 7 U.S.C. §§ 2(a)(1)(C)(i)(I), 2(a)(1)(C)(iv), 6b(e).

¹⁴ *E.g.*, 7 U.S.C. § 2(a)(1)(C)(ii).

¹⁵ CEA section 5c(c)(5)(C)(i); 7 U.S.C. § 7a-2(c)(5)(C)(i)

¹⁶ *Id.*

commodity, and the contract must “involve” an enumerated activity. But the contract need not be “based upon” an enumerated activity.

WHEREAS, Congress’s choice of the broader term “involve” means that CEA section 5c(c)(5)(C)(i) can capture both contracts whose underlying *is* one of the enumerated activities, and contracts with a different connection to one of the enumerated activities because, for example, they “relate closely” to, “entail,” or “have as an essential feature or consequence” one of the enumerated activities.¹⁷

WHEREAS, the legislative history of CEA section 5c(c)(5)(C) supports the plain meaning of the term “involve,”¹⁸ and indicates that the question for the Commission in determining whether a contract “involves” one of the activities enumerated in CEA section 5c(c)(5)(C)(i) is whether the contract, considered as a whole, involves one of those activities.¹⁹

¹⁷ The types of activities enumerated in CEA section 5c(c)(5)(C)(i) – including terrorism, war, and activities that are unlawful under federal or state law – of themselves support a broad reading of the term “involve,” to ensure that the Commission has the authority that Congress intended to prevent trading on Commission-regulated markets that is contrary to the public interest. *See* footnotes 29 and 31, *infra*

¹⁸ In a colloquy with Senator Diane Feinstein on the Senate floor regarding the proposed Dodd-Frank Act provision that ultimately was enacted as CEA section 5c(c)(5)(C), Senator Blanche Lincoln, then-Chair of the Senate Committee on Agriculture, Nutrition and Forestry, stated that, among other things, the provision was intended to “prevent gambling through futures markets” and to restrict exchanges from “construct[ing] an ‘event contract’ around sporting events such as the Super Bowl, the Kentucky Derby, and Masters Golf Tournament.” *See* 156 Cong. Rec. S5906-07 (daily ed. July 15, 2010) (statements of Sen. Diane Feinstein and Sen. Blanche Lincoln), available at <https://www.congress.gov/111/crec/2010/07/15/CREC-2010-07-15-senate.pdf>. None of the Super Bowl, the Kentucky Derby, or the Masters Golf Tournament are, of themselves, “gaming.” Rather, the statement of Senator Lincoln, who is identified in the colloquy as one of the authors of CEA section 5c(c)(5)(C), focuses on the overall characteristics of the contract. It does not base the evaluation of whether the contract involves an enumerated activity – here, “gaming” – on the underlying alone. Indeed, it is difficult to conceive of a contract whose underlying event, itself, is “gaming.” If “involve” were to refer only to a contract’s underlying, contracts based on the outcome of sporting events such as horse races and football games would not qualify, because sports typically are not understood to be “gaming” – they are understood to be “games.” In effect, if “involve” were to refer only to a contract’s underlying, the scope of certain prongs of CEA section 5c(c)(5)(C)(i) could effectively be limited to a null set of event contracts, which could not have been Congress’s intent.

¹⁹ For example, giving the term its ordinary meaning, a contract “involves” one of the activities enumerated in CEA section 5c(c)(5)(C)(i) if trading in the contract amounts to the enumerated activity.

Gaming

WHEREAS, the term “gaming” is not defined in the CEA or Commission regulations.

WHEREAS, as discussed above, an undefined term in a statute is generally given its ordinary meaning, and to determine the ordinary meaning of undefined statutory terms, courts typically look to dictionary definitions for guidance. In addition, courts consider the construction of similar terms in other statutes, as well as the purpose of the statute being interpreted.²⁰

WHEREAS, the term “gaming” includes betting or wagering on elections, as demonstrated by the following:

- A. Dictionaries define the term “gaming” to mean “gambling.”²¹
- B. Under most state laws, “gambling” involves a person staking something of value upon the outcome of a game, contest, or contingent event.²²

²⁰ See, e.g., *Sanders v. Jackson*, 209 F.3d 998, 1000-02 (7th Cir. 2000).

²¹ See, e.g., *Gaming Definition*, MERRIAM-WEBSTER.COM, <http://www.merriam-webster.com/dictionary/gaming> (defining the noun “gaming” as “the practice or activity of playing games for stakes: gambling”) (last visited March 14, 2023); *Gaming Definition*, DICTIONARY.COM, <https://www.dictionary.com/browse/gaming> (defining “gaming” as “gambling”) (last visited Sept. 7, 2023); *Gaming Definition*, Black’s Law Dictionary, <https://thelawdictionary.org/gaming/> (last visited September 10, 2023) (refers to gambling as gaming and cross-refers the definition to gambling).

²² See, e.g., GA. CODE ANN. § 16-12-21(a)(1) (West 2020) (“ . . . A person commits the offense of gambling when he . . . [m]akes a bet upon the partial or final result of any game or contest or upon the performance of any participant in such game or contest”); KY. REV. STAT. ANN. § 528.010(6)(a) (West 2023) (“‘Gambling’ means staking or risking something of value upon the outcome of a contest, game, gaming scheme, or gaming device which is based upon an element of chance, in accord with an agreement or understanding that someone will receive something of value in the event of a certain outcome.”); MICH. COMP. LAWS § 750.301 (2023) (“Any person or his or her agent or employee who, directly or indirectly, takes, receives, or accepts from any person any money or valuable thing with the agreement, understanding or allegation that any money or valuable thing will be paid or delivered to any person where the payment or delivery is alleged to be or will be contingent upon the result of any race, contest, or game or upon the happening of any event not known by the parties to be certain”); N.Y. PENAL LAW § 225.00(2) (McKinney 2015) (“A person engages in gambling when he stakes or risks something of value upon the outcome of a contest of chance or a future contingent event not under his control or influence, upon an agreement or understanding that he will receive something of value in the event of a certain outcome.”); TEX. PENAL CODE ANN. § 47.02(a) (West 2019) (“A person commits an offense [of gambling] if he: (1) makes a bet on the partial or final result of a game or contest or on the performance of a participant in a game or contest”); VA. CODE ANN. § 18.2-325(1) (West 2022) (“‘Illegal gambling’ means the making, placing, or receipt of any bet

- C. The Unlawful Internet Gambling Enforcement Act (“UIGEA”), a federal statute, defines the term “bet or wager” as “the staking or risking by any person of something of value upon the outcome of a contest of others, a sporting event, or a game subject to chance, upon an agreement or understanding that the person or another person will receive something of value in the event of a certain outcome”²³
- D. To bet or wager on elections is to stake something of value upon the outcome of contests of others, namely, contests between electoral candidates.
- E. Several state statutes, on their face, link the terms “gaming” or “gambling” to betting or wagering on elections.²⁴

or wager . . . of money or other consideration or thing of value, made in exchange for a chance to win a prize, stake, or other consideration or thing of value, dependent upon the result of any game, contest, or any other event the outcome of which is uncertain or a matter of chance”)

²³ 31 U.S.C. § 5362(1)(A). The UIGEA, 31 U.S.C. §§ 5361-5367 (2006), prohibits gambling businesses from knowingly accepting payments in connection with the participation of another person in a bet or wager that involves the use of the Internet and that is unlawful under any federal or state law. Unlike the Wire Act, 28 U.S.C. § 1084 (1961), the UIGEA defines a “bet or wager”, but it criminalizes it only if it is connected with unlawful Internet gambling that violates any federal or state law. *See* 31 U.S.C. § 5362. The UIGEA does not alter the definitions in other federal and state laws and expressly excludes any transaction conducted on or subject to the rules of a registered entity or exempt board of trade under the CEA from the definition of “bet or wager.” *See id.* at § 5362 (1)(E).

²⁴ *See, e.g.*, 720 ILL. COMP. STAT. ANN. 5/28-1 (West 2011) (“A person commits gambling when he . . . [m]akes a wager upon the result of any game, contest, or any political nomination, appointment or election”); NEB. REV. STAT. § 28-1101(4) (2011) (“A person engages in gambling if he or she bets something of value . . . upon the outcome of a game, contest, or election”); N.M. STAT. ANN. § 44-5-10 (1978) (“Bets and wagers authorized by the constitution and laws of the United States, or by the laws of this state, are gaming within the meaning of this chapter.”); N.D. CENT. CODE ANN. § 12.1-28-01 (West 2011) (“Gambling means risking any money . . . upon . . . the happening or outcome of an event, including an election . . . over which the person taking the risk has no control.”). *See also* GA. CODE ANN. § 16-12-21(a)(2) (West 2011) (“A person commits the offense of gambling when he . . . [m]akes a bet upon the result of any political nomination, appointment, or election”); MISS. CODE ANN. § 97-33-1 (West 2011) (“If any person . . . shall wager or bet . . . upon the result of any election . . . he shall be fined in a sum not more than Five Hundred Dollars”); S.C. CODE ANN. § 16-19-90 (2011) (“Any person who shall make any bet or wager of money . . . upon any election in this State shall be guilty of a misdemeanor”); TEX. PENAL CODE ANN. § 47.02(a)(2) (West 2011) (“A person commits an offense if he . . . makes a bet on the result of any political nomination, appointment, or election”).

WHEREAS, the Congressional Control Contracts involve “gaming,” pursuant to CEA section 5c(c)(5)(C)(i) and Commission Regulation 40.11(a)(1), because taking a position in the Congressional Control Contracts would be staking something of value upon the outcome of a contest of others. The Congressional Control Contracts are premised on the outcome of Congressional election contests, which ultimately determine the party affiliation of the Speaker and the Pres Pro Temp.²⁵

²⁵ Kalshi argues that elections are not “contests” even if they are at base competitions, and that, if the Congressional Control Contracts constitute gaming, all event contracts are also arguably gaming. Certain commenters agreed, with one arguing that the Congressional Control Contracts are no more like gaming than anything else trading in traditional financial markets, and another arguing that recognizing the Congressional Control Contracts as gaming would imply that all futures contracts are gaming. The Commission disagrees, and notes, first, that it is common parlance to refer to elections as contests. *See, e.g., A Frozen Needle in GOP Contest*, The Washington Post (Sept. 3, 2023); *Biden: Dems revitalizing manufacturing*, Houston Chronicle (Sept. 10, 2022) (discussing the “contest to control Congress”). One commenter similarly stated that elections fall squarely within the definition of a “contest,” citing the following definition in the Cambridge English Dictionary: “a competition to do better than other people, esp. to win a prize or achieve a position of leadership or power: ‘In the last election, he survived a close contest against a political newcomer.’” Moreover, the Commission reiterates that many state statutes, on their face, specifically link the terms gaming and gambling to betting or wagering on elections. As such, unlike all futures contracts (or all financial instruments), the Congressional Control Contracts fall squarely within statutory definitions of gaming. More generally, the Commission notes that a common thread throughout the large majority of definitions of “gaming” and “gambling” is the act of staking something of value on the outcome of a contest of others. To take a position in the Congressional Control Contracts would be to stake something of value upon the outcome of a contest of others, since the Congressional Control Contracts are premised on the outcome of contests between electoral candidates (which ultimately determine the party affiliation of the Speaker and the Pres Pro Temp). By contrast, futures contracts traditionally have not been premised on the outcome of a contest of others. As discussed *infra*, futures contracts traditionally have served hedging and risk management functions, and have therefore been designed to correlate to direct and quantifiable changes in the price of commodities or other financial assets or instruments. As also discussed *infra*, the economic impacts of the outcome of contests for Congressional control are too diffuse and unpredictable to serve the hedging and risk management functions that futures contracts have traditionally been intended to serve.

Activity That Is Unlawful Under State Law

WHEREAS, in many states, betting or wagering on elections is prohibited by statute²⁶ or common law.²⁷

²⁶ ARIZ. REV. STAT. ANN. § 16-1015 (“A person who, before or during an election provided by law, knowingly makes, offers or accepts a bet or wager . . . upon any contingency whatever arising out of [an] election, is guilty of a class 2 misdemeanor.”); ARK. CODE ANN. § 7-1-103 (20) (West) (“No person shall make any bet or wager upon the result of any election . . .”); COLO. REV. STAT. ANN. § 31-10-1531 (West) (“It is unlawful for any person, including any candidate for public office, before or during any municipal election, to make any bet or wager with a qualified elector or take a share or interest in, or in any manner become a party to, any such bet or wager or provide or agree to provide any money to be used by another in making such bet or wager upon any event or contingency whatever arising out of such election.”); GA. CODE. ANN. § 16-12-21(a)(2) (West 2011) (“A person commits the offense of gambling when he . . . [m]akes a bet upon the result of any political nomination, appointment, or election . . .”); IDAHO CODE ANN. § 18-2314 (West) (“Every person who makes, offers, or accepts any bet or wager upon the result of any election . . . is guilty of a misdemeanor.”); 720 ILL. COMP. STAT. ANN. 5/28-1 (West 2011) (“A person commits gambling when he . . . [m]akes a wager upon the result of any game, contest, or any political nomination, appointment or election . . .”); MD CODE, ELECTION LAW § 16-902 (“A person may not make a bet or wager on the outcome of an election held under this article.”); MICH COMP. LAWS ANN. § 168.931 (I) (West) (“A person shall not keep a room or building for the purpose, in whole or in part, of recording or registering bets or wagers, or of selling pools upon the result of a political nomination, appointment, or election.”); MISS. CODE ANN. § 97-33-1 (West 2011) (“If any person . . . shall wager or bet . . . upon the result of any election . . . he shall be fined in a sum not more than Five Hundred Dollars . . .”); NEB. REV. STAT. § 28-1101(4) (2011) (“A person engages in gambling if he or she bets something of value . . . upon the outcome of a game, contest, or election . . .”); NEV. REV. STAT. ANN. § 293.830 (West) (“Any person who makes, offers or accepts any bet or wager upon the result of any election . . . is guilty of a gross misdemeanor.”); N.J. STAT. ANN. § 19:34-24 (West) (“No person shall make, lay or deposit any bet, wager or stake, to be decided by the result of any election . . . or by any contingency connected with or growing out of any election.”); N.C. GEN. STAT. ANN. § 163-274 (“It shall be unlawful . . . [f]or any person to bet or wager any money or other thing of value on any election.”); N.D. CENT. CODE ANN. § 12.1-28-01 (West 2011) (“Gambling’ means risking any money . . . upon . . . the happening or outcome of an event, including an election . . .”); OKLA STAT. ANN. TIT. 21, § 181 (West) (“Every person who makes, offers or accepts any bet or wager upon the result of any election . . . is guilty of a misdemeanor.”); OR. REV. STAT. ANN. § 260.635 (West) (“No candidate shall make or become party to a bet of anything of pecuniary value on any event or contingency relating to a pending election” and “[n]o person, to influence the result of any election, shall make a bet of anything of pecuniary value on the result of a pending election, or on any event relating to it.”); 18 PA. STAT. § 5514 (West) (“A person is guilty of a misdemeanor of the first degree if he . . . receives, records, registers, forwards, or purports or pretends to forward, to another, any bet or wager upon the result of any political nomination, appointment or election . . .”); S.C. CODE ANN. § 16-19-90 (2011) (“Any person who shall make any bet or wager of money . . . upon any election in this State shall be guilty of a misdemeanor . . .”); TENN. CODE ANN. § 2-19-129 (West) (“A person commits a Class C misdemeanor if such person makes any bet or wager of money or other valuable thing upon any election.”); TEX. PENAL CODE ANN. § 47.02(a)(2) (West 2011) (“A person commits an offense if he . . . makes a bet on the result of any political nomination, appointment, or election . . .”); W. VA. CODE ANN. § 3-9-22 (West) (“It shall be unlawful to bet or wager money or other thing of value on any election held in this state”). A number of states also have more limited statutes in place. See, e.g., S.D. CODIFIED LAWS § 12-26-19 (“Any person who shall directly or indirectly make a bet with a voter depending upon the result of any election, with the intent thereby to procure the challenge of such voter or to prevent his voting at an election, is guilty of a Class 2 misdemeanor.”); WIS. STAT. ANN. § 6.03 (West) (“No person shall be allowed to vote in any election in which the person has made or become interested, directly or indirectly, in any bet or wager depending upon the result of the election.”).

WHEREAS, the Congressional Control Contracts involve “activity that is unlawful under ... State law,” pursuant to CEA section 5c(c)(5)(C)(i) and Commission Regulation 40.11(a)(1), because taking a position in the Congressional Control Contracts would be staking something of value upon the outcome of contests between electoral candidates (which ultimately

²⁷ Alabama, *White v. Yarbrough*, 16 Ala. 109, 110 (1849) (“A wager on an election is void as against public policy”); Arkansas, *Williams v. Kagy*, 3 S.W.2d 332, 333-34, 176 Ark. 484, 3 (1928) (“Even before the passage of the statute quoted, this court ruled . . . that wagers upon elections then pending are calculated to endanger the peace and harmony of society and have a corrupting influence upon the morals and are contrary to sound policy”); Colorado, *Maher v. Van Horn*, 60 P. 949, 17-18 (Colo. 1900) (“[W]ager contracts on the result of elections are contrary to public policy and void and will not be enforced by the courts”); Delaware, *Gardner v. Nolen*, 3 Del. 420, 420 (Del. Super. Ct. 1842) (“As within the policy of prohibiting betting on elections, an election wager cannot be recovered though laid after the closing of the polls”); Georgia, *McLennan v. Whidon*, 48 S.E. 201, 202-03, 120 Ga. 666 (1904), quoting *Leverett v. Stegal*, 23 Ga. 259 (1857) (finding that all gambling contracts are illegal but noting that “If there be any class of gambling contracts which should be frowned upon more than another it is bets on elections. They strike at the foundations of popular institutions, corrupt the ballot box, or, what is tantamount to it, interfere with the freedom and purity of elections”); Indiana, *Worthington v. Black*, 13 Ind. 344, 344-345 (1859) (“It has been often decided that wagers upon the result of an election are against the principles of sound policy, and consequently illegal . . .”); Iowa, *David v. Ransom*, 1 Greene 383, 383-85 (Iowa 1848) (“A wager or bet made between parties on the result of an election is void. If the wager is made before an election, illegal votes are often secured, and others induced, contrary to the better judgment of the voter; or if made after an election, the parties interested might be led to exert a corrupt influence upon the canvassing, and returns of the votes”); Kansas, *Reynolds v. McKinney*, 4 Kan. 94, 101 (1866) (“[A bet] involving an inquiry into the validity of the election of a public officer. . . . was therefore, illegal and void on principles of public policy”); Massachusetts, *Ball v. Gilbert*, 53 Mass. 397, 400-02 (1847) (a wager upon the event of an election to a public office - at the federal, state, or local level - is illegal and void on numerous public policy grounds); Missouri, *Hickerson v. Benson*, 8 Mo. 8 (1843) (wagers on the result of public elections and collateral matters are “clearly” against public policy and “sound morality” and consequently illegal and void at common law); Nebraska, *Specht v. Beindorf*, 56 Neb. 553, 76 N.W. 1059 (1898) (promissory note premised on the election of a public official is a wager on the result of an election and void on grounds of public policy); New York, *Rust v. Gott*, 1828 WL 1964 (N.Y. Sup. Ct. 1828) (wager on the event of an election is illegal and void, even where made after the poll of election is closed but before the canvass is complete); North Carolina, *Bettis v. Reynolds*, 34 N.C. 344, 345-48 (1851) (“the practice of betting on elections has a direct tendency to cause undue influence[.]” and even where neither party was a voter, a wager on the result of a Presidential election void as against public policy); Oregon, *Willis v. Hoover*, 9 Or. 418, 419-20 (1881) (wagers on the result of public elections are illegal and void upon grounds of public policy); Rhode Island, *Stoddard v. Martin*, 1 R.I. 1, 1 (1828) (all wagers on elections and judicial decisions “are of immoral tendency, against sound policy,” and therefore void); Tennessee, *Russell v. Pyland*, 21 Tenn. 131, 133 (1840) (a note premised on the outcome of an election is illegal and void under common law principles); Texas, *Thompson v. Harrison*, 1842 WL 3625, at *1 (Tex. 1842) (wagers on the result of public elections are “contrary to good morals” and void on grounds of public policy); Wisconsin, *Murdock v. Kilbourn*, 6 Wis. 468, 470-71 (1857) (wager upon the event of a public election is contrary to public policy, illegal, and void).

determine the party affiliation of the Speaker and the Pres Pro Temp), and in many states such conduct is illegal.²⁸

The Congressional Control Contracts Are Contrary to the Public Interest

WHEREAS, the Commission has evaluated whether the Congressional Control Contracts are contrary to the public interest.

WHEREAS, the legislative history of CEA section 5c(c)(5)(C) indicates Congressional intent for the Commission to consider, among other things, in its evaluation of whether a contract is contrary to the public interest for purposes of that provision, a form of the “economic purpose test” that was applied to determine whether a contract was contrary to the public interest under former CEA section 5(g) prior to its deletion by the Commodity Futures Modernization Act of 2000 (“CFMA”).²⁹

²⁸ Kalshi argues that many state gaming laws carve out exceptions for Commission-regulated products and, relatedly, that the Commission’s jurisdiction over futures and swaps preempts any state gaming laws as to those products. Seen in this context, Kalshi argues, the state laws that prohibit betting or wagering on elections do not and cannot refer to Commission-regulated event contracts, and the Congressional Control Contracts are therefore not unlawful under state law. This misses the point. CEA section 2(a)(1) grants the Commission “exclusive jurisdiction” over futures and swaps traded on a DCM. 7 U.S.C. § 2(a)(1). This “preempts the application of state law,” *Leist v. Simplot*, 638 F.2d 283, 322 (2d Cir. 1980), so transacting these products on a DCM cannot, in and of itself, be an “activity that is unlawful under any ... State law.” On the other hand, these products may still “involve ... activity” that is unlawful under a state law, in the sense, for example, that transactions in the products may “relate closely” to, “entail,” or “have as an essential feature or consequence” an activity that violates state law. *See* Merriam-Webster, *available at* <https://www.merriam-webster.com/dictionary/involve> (last visited Oct. 12, 2022); Random House College Dictionary 703 (Revised ed. 1979); Riverside University Dictionary 645 (1983). Here, state laws (that are not preempted by the CEA) prohibit wagering on elections. Taking a position in the Congressional Control Contracts would be staking something of value on the outcome of contests between electoral candidates, such that wagering on elections is “an essential feature or consequence” of the contracts. Thus, while transactions in the Congressional Control Contracts on a DCM do not violate, for example, state bucket-shop laws, they nevertheless involve an activity that is unlawful in a number of states—wagering on elections. To permit such transactions on a DCM would undermine important state interests expressed in statutes separate and apart from those applicable to trading on a DCM.

²⁹ 7 U.S.C. § 7(g), *as amended* by the Commodity Futures Trading Commission Act of 1974, Pub. L. 93-463, 8 Stat. 1389 (1974). In the colloquy between Senator Feinstein and Senator Lincoln on the Senate floor regarding the proposed Dodd-Frank Act provision that ultimately was enacted as CEA section 5c(c)(5)(C), Senator Feinstein referenced the Commission’s pre-CFMA authority “to prevent trading that is contrary to the public interest,” and asked Senator Lincoln whether, with respect to CEA section 5c(c)(5)(C), the intent was to “define ‘public interest’ broadly so that the CFTC may consider the extent to which a proposed derivative contract would be used

WHEREAS, the general “Findings and Purpose” provision of the CEA, at CEA section 3, states that “[t]he transactions subject to [the CEA] . . . are affected with a national public interest by providing a means for managing and assuming price risks, discovering prices, or disseminating pricing information through trading in liquid, fair, and secure financial facilities,”³⁰ and thus recognizes hedging – and, in particular, price hedging (the “managing [of] price risks”) – as a public interest that transactions subject to the CEA are intended to serve.

WHEREAS, the Commission has the discretion to consider other factors in its evaluation of whether a contract is contrary to the public interest for purposes of CEA section 5c(c)(5)(C), and the legislative history of CEA section 5c(c)(5)(C) supports consideration of whether a contract may threaten the public good.³¹

predominantly by speculators or participants not having a commercial or hedging interest.” Senator Feinstein asked whether the Commission would “have the power to determine that a contract is a gaming contract if the predominant use of the contract is speculative as opposed to a hedging or economic use[.]” and Senator Lincoln replied, “That is our intent.” *See* 156 Cong. Rec. S5906-07 (daily ed. July 15, 2010) (statements of Sen. Diane Feinstein and Sen. Blanche Lincoln), available at <https://www.congress.gov/111/crec/2010/07/15/CREC-2010-07-15-senate.pdf>. Pre-CFMA Commission guidelines articulated the economic purpose test as an evaluation of “whether [a] contract reasonably can be expected to be, or has been, used for hedging and/or price basing on more than an occasional basis.” 17 C.F.R. § 5, Appendix A- Guideline No. 1 (repealed 2001). The colloquy between Senators Feinstein and Lincoln suggests a modification of the “on more than an occasional basis” standard; it suggests that the Commission should consider whether a contract is used predominantly by speculators or market participants not having a commercial or hedging interest.

³⁰ CEA section 3(a); 7 U.S.C. § 5(a). Section 3 further states that it is the purpose of the CEA to serve such public interests “through a system of effective self-regulation of trading facilities, clearing systems, market participants and market professionals under the oversight of the Commission.” CEA section 3(b); 7 U.S.C. § 5(b).

³¹ In the colloquy on the Senate floor, Senator Lincoln further confirmed for Senator Feinstein that CEA section 5c(c)(5)(C) would empower the Commission to prevent trading in contracts “that may serve a limited commercial function but threaten the public good by allowing some to profit from events that threaten our national security.” Senator Lincoln cited terrorist attacks, war and hijacking as examples of events that “pose a real commercial risk to many businesses in America,” but stated that “a futures contract that allowed people to hedge that risk would also involve betting on the likelihood of events that threaten our national security. That would be contrary to the public interest.” Senator Feinstein thanked Senator Lincoln for this confirmation, concluding that, “[a] futures market is for hedging.” *See* 156 Cong. Rec. S5906-07 (daily ed. July 15, 2010) (statements of Sen. Diane Feinstein and Sen. Blanche Lincoln), available at <https://www.congress.gov/111/crec/2010/07/15/CREC-2010-07-15-senate.pdf>.

WHEREAS, in light of the foregoing, in evaluating whether the Congressional Control Contracts are contrary to the public interest, the Commission has considered the contracts' hedging utility and price-basing utility.³² Additionally, the Commission has considered the potential impact that trading in the Congressional Control Contracts may have on election integrity, or the perception of election integrity – as well as the extent to which permitting trading in the Congressional Control Contracts could require the Commission to assume a role in overseeing the electoral process.³³

Hedging and Price Basing Utility

WHEREAS, control of a chamber of Congress does not, in and of itself, have sufficiently direct, predictable, or quantifiable economic consequences for the Congressional Control Contracts to serve an effective hedging function.

WHEREAS, the Commission has considered comments from Kalshi and others that state that Congressional control impacts a wide variety of assets and cash flows, for a variety of

³² See footnote 29, *supra*.

³³ In making findings regarding whether the Congressional Control Contracts are contrary to the public interest, the Commission distinguishes two staff no-action positions referenced by some commenters that have been issued by the Commission's Division of Market Oversight ("Division") to two academic institutions. Subject to specified terms, these no-action positions state that the Division will not recommend enforcement action against the academic institutions for operating, without registration as a DCM, SEF, or foreign board of trade, small-scale not-for-profit markets that offer trading in political and economic indicator event contracts for academic purposes. CFTC Staff Letter No. 93-66 (June 18, 1993), issued to the University of Iowa, *available at* <https://www.cftc.gov/sites/default/files/idc/groups/public/@lrllettergeneral/documents/letter/93-66.pdf>; CFTC Staff Letter No. 14-130 (Oct. 29, 2014), issued to Victoria University of Wellington, New Zealand, *available at* <https://www.cftc.gov/cs/14-130/download>. The terms of these staff no-action positions contemplate that each market will be operated by the relevant academic institution for academic purposes and without compensation. The terms of the no-action positions also contemplate limitations on, among other things, the number of market participants and the number of contracts that each market participant may hold. In issuing the no-action positions, the Division did not recognize the political event contracts that would be offered by the markets as having hedging or price-basing utility. In issuing each of the no-action positions, the Division explicitly noted that it was not rendering an opinion on the legality of the academic institutions' activities under state law. Kalshi has not submitted that the Congressional Control Contracts would be subject to analogous limitations to those contemplated under the Division's no-action positions, including limitations providing for the market for the Congressional Control Contracts to be operated on a small-scale, not-for-profit basis for academic purposes.

entities, and that market participants already engage in behavior aimed at hedging risks related to Congressional control. Kalshi notes that Congress has extensive powers to influence the economy and that shifts in political power often portend changes in policy.

WHEREAS, the Commission has considered detailed examples provided by Kalshi of statements from private research firms attempting to predict broad-ranging economic impacts of various political outcomes, and academic research indicating that the marketplace generally considers political risks in its operation (citing, for example, links between changes in the price of equities and other assets, and expected changes in Congressional control).

WHEREAS, the Commission has also considered similar assertions from commenters that the effect of Congressional control on the economy is sufficiently predicable and measurable for the Congressional Control Contracts to have a hedging purpose.

WHEREAS, conversely, several commenters expressed the view that the economic effects of Congressional control are too attenuated and unpredictable for the Congressional Control Contracts to serve as an effective hedging tool.

WHEREAS, the Commission finds that while control of a chamber of Congress may ultimately have economic effects, those eventual economic effects are both diffuse and unpredictable. While the likelihood of adoption of a given policy may increase or decrease based on the composition of Congress, many intervening events and variables exist between control of a chamber of Congress and the actual implementation of such a policy.³⁴ Furthermore,

³⁴ There are several steps required to enact legislation. Proposed legislation must be approved by both chambers of Congress and by signature of the president or a Congressional override of a presidential veto. During that process, the nature of proposed legislation can change in dramatic ways. Beyond that, legislation requires implementation and is subject to judicial review. All of these dynamics make it difficult to predict the nature, magnitude, and timing of policy outcomes resulting from a given party's control of a chamber of Congress.

the likelihood of implementation is not dependent on control of a chamber of Congress alone; it also depends upon many other things, including, for example, whether a party controls one or both chambers of Congress, the size of its majority, votes by individual party members, and the political affiliation of the president.

WHEREAS, control of a chamber of Congress could, following a number of independent intervening events, generally affect a wide variety of personal liabilities and economic factors, but that does not establish that the Congressional Control Contracts can be used for specific, identifiable hedging purposes and thus does not establish the hedging utility of the Congressional Control Contracts. Rather, it further indicates that control of a chamber of Congress does not have a direct, predictable, or quantifiable impact on any commodity or other financial asset.³⁵

WHEREAS, the Congressional Control Contracts result, upon settlement, in a payout of either \$1 or \$0, depending on the party in control of the relevant chamber of Congress, with settlement and payout occurring only once every two years, to coincide with the election cycle.

³⁵ Kalshi implies that the Congressional Control Contracts should be permitted to trade because certain other contracts currently trading on Commission-regulated exchanges involve a degree of removal from the actual risk that is intended to be hedged. As a preliminary matter, the Commission notes that an exchange's certification of a product for trading pursuant to CEA section 5c(c)(1) and Commission Regulation 40.2 does not entail or amount to Commission approval of that product. Further, while Kalshi does not cite to specific contracts in most of the examples it provides, the contracts that Kalshi appears to be referring to for comparison generally have more specific and targeted hedging utility than the Congressional Control Contracts and are otherwise materially different from such contracts. For example, Heating and Cooling Degree Day futures contracts that Kalshi appears to reference do not settle based on an overarching nationwide heating degree day/cooling degree day calculation – they settle based on a calculation at a very specific location. Similarly, real estate index contracts that Kalshi appears to reference settle based on the value of the index in a specific metropolitan area, with the index itself based on real estate price values. In contrast, the Congressional Control Contracts are based on which political party will control the relevant chamber of Congress – they are not based on or tied to any actual price or related values. Furthermore, certain of the event contracts that Kalshi appears to reference do not fall within the scope of CEA section 5c(c)(5)(C) and Commission Regulation 40.11 – which apply with respect to contracts in certain types of excluded commodities – and most of the contracts that Kalshi appears to reference are not event contracts at all.

WHEREAS, the payout for the Congressional Control Contracts is not tied in any way to actual or estimated losses incurred elsewhere, and a loss on the Congressional Control Contracts is not offset by a related gain elsewhere, as is the case for contracts with hedging and risk management capabilities.

WHEREAS, the binary payout of the Congressional Control Contracts further limits their utility as a vehicle for hedging any eventual economic effects resulting from which party controls a chamber of Congress, as does their frequency of settlement.

WHEREAS, price-basing occurs when producers, processors, merchants, or consumers of a commodity establish commercial transaction prices based on the futures price for that or a related commodity.³⁶

WHEREAS, the Commission has considered comments from Kalshi and others that the outcome of Congressional elections could affect the pricing of a number of diverse commercial transactions because the outcome could impact the pricing of various commodities underlying those transactions.

WHEREAS, other commenters stated that the Congressional Control Contracts cannot have price-basing utility for the same reason that they do not have hedging utility – namely, that the economic ramifications of an election are indirect and unpredictable, and therefore cannot help determine the price of a commodity or financial asset in a predictable manner.

WHEREAS, even if some level of political risk may be embedded in the pricing of many commercial transactions, that does not, in itself, support a finding that the Congressional Control Contracts serve a price-basing function.

³⁶ See CFTC Futures Glossary, available at <https://www.cftc.gov/LearnAndProtect/AdvisoriesAndArticles/CFTCGlossary/index.htm#P>.

WHEREAS, since the economic effects of control of a chamber of Congress are diffuse and unpredictable, the price of the Congressional Control Contracts is not directly correlated to the price of any commodity, and so the price of the Congressional Control Contracts could not predictably be used to establish commercial transaction prices.

WHEREAS, in light of the foregoing, the Commission finds that it has not been demonstrated that the Congressional Control Contracts could reasonably be expected to be used for hedging and/or price basing on more than an occasional basis or that the Congressional Control Contracts could reasonably be expected to be used predominantly by market participants having a commercial or hedging interest.

Election Integrity and the Commission’s Role in the Electoral Process

WHEREAS, more than 600 commenters – a significant proportion of the public commenters on the Submission – expressed concerns about the effect that the Congressional Control Contracts could have on election integrity, including concerns that the Congressional Control Contracts are inconsistent with ideals of democracy and the sanctity of the electoral process.

WHEREAS, these commenters included members of Congress, who expressed concern about the potential impact of the Congressional Control Contracts on the electoral process. A comment letter from six United States Senators stated that “[e]stablishing a large-scale, for-profit political event betting market in the United States ... would profoundly undermine the sanctity and democratic value of elections ... There is no doubt that mass commodification of our

democratic process would raise widespread concerns about the integrity of our electoral process.”³⁷

WHEREAS, the Congressional Control Contracts could potentially be used in ways that would have an adverse effect on the integrity of elections, or the perception of integrity of elections – for example, by creating monetary incentives to vote for particular candidates, even when such votes may be contrary to a voter’s (or an organized group of voters’) political preferences or views of such candidates.

WHEREAS, the Congressional Control Contracts raise concerns that conduct designed to artificially affect the electoral process could also, intentionally or otherwise, manipulate the market in the Congressional Control Contracts, or that the market in the Congressional Control Contracts could be manipulated to influence elections or electoral perceptions. In particular, several commenters (including members of Congress) stated that the Congressional Control Contracts could incentivize the spread of misinformation by individuals or groups seeking to influence perceptions of a political party or a party candidate’s success.

WHEREAS, the public interest in guarding against such misinformation is all the more pressing in the context of contracts rooted in the outcome of United States federal elections.³⁸

³⁷ The signatories to the letter are Senators Jeffrey Merkley, Sheldon Whitehouse, Edward Markey, Elizabeth Warren, Chris Van Hollen, and Diane Feinstein (the “Six Senators”). Senator Amy Klobuchar filed a separate comment letter expressing “concern” with the Submission. The comment letter from the Six Senators underscores differences between a potential market for the Congressional Control Contracts and the markets for political event contracts in respect of which the Division has previously issued staff no-action positions. Kalshi is a for-profit entity seeking to offer a broad-based market in the Congressional Control Contracts. Kalshi has not submitted that the Congressional Control Contracts would be subject to analogous limitations to those contemplated under the Division’s no-action positions. In particular, Kalshi has not submitted that the markets for the Congressional Control Contracts would be operated on a small-scale, not-for-profit basis for academic purposes.

³⁸ Kalshi cites to a paper on the history of election betting in the United States for the premise that such betting did not negatively affect the political process. See Paul Rhode and Coleman Strumpf, “Historical Presidential Betting Markets,” *Journal of Economic Perspectives*, Vol. 18, No. 2 (Spring 2004). The Commission notes that the markets examined in that study existed in a very different historical context – before 1940 – and that the study nonetheless

WHEREAS, the Congressional Control Contracts have no underlying cash market with bona fide economic transactions to provide directly correlated price forming information. Rather, price forming information for the Congressional Control Contracts is driven in large measure by polling, voter surveys, and other informational sources that are unregulated, frequently have opaque underlying processes and procedures, and may not follow scientifically reliable methodologies. This differs from the informational sources (*e.g.*, government issued crop forecasts, weather forecasts, federal government economic data, market-derived supply and demand metrics for commodities, market-based interest rate curves, etc.) used for pricing the vast majority of commodities underlying Commission-regulated derivatives contracts.

WHEREAS, the opaque and unregulated sources of price forming information for the Congressional Control Contracts may increase the risk of manipulative activity relating to the trading and pricing of the contracts, while decreasing Kalshi's and the Commission's ability to detect such activity.

WHEREAS, the Commission has considered assertions by Kalshi and other commenters that the Congressional Control Contracts would serve as a check on misinformation and inaccurate polling, stating that market-based alternatives tend to be more accurate than polling or other methods of predicting election outcomes.

acknowledges both attempts to manipulate the odds and concerns that the betting markets provided a potential means of influencing elections. Several other commenters noted specific examples of manipulation or attempted manipulation incidents on election markets, while others downplayed these incidents.

WHEREAS, there is also research suggesting that election markets may incentivize the creation of “fake” or unreliable information in the interest of moving the market, and a number of commenters also raised this concern.³⁹

WHEREAS, the Congressional Control Contracts prohibit certain individuals and entities likely to have a stake in the outcome of elections from trading in the contracts – including paid employees of political campaigns and major polling organizations. However, these trading prohibitions would not prevent such individuals and entities from engaging in other activity – intended to create the impression of likely electoral success or failure on the part of a particular political candidate or candidates – that could artificially move the market in the Congressional Control Contracts.

WHEREAS, the trading prohibitions for the Congressional Control Contracts also do not exclude all individuals or entities who could have a motivation to create the impression of likely electoral success or failure on the part of a political candidate or candidates.⁴⁰

WHEREAS, if trading in the Congressional Control Contracts were to be permitted, the Commission, as regulator of the markets in those contracts, would be required to investigate suspected manipulation in those markets. By extension, the Commission could find itself investigating election-related activities – potentially including the outcome of an election itself. Several commenters stated that this was not a role for which the Commission is equipped or

³⁹ See Yeargain, Tyler, “Fake Polls, Real Consequences: The Rise of Fake Polls and the Case for Criminal Liability,” *Missouri Law Review*, Volume 85, Issue 1 (Winter 2020) *citing* Enten, Harry, “Fake Polls are a Real Problem,” *available at* <https://fivethirtyeight.com/features/fake-polls-are-a-real-problem/> (Aug. 22, 2017) (noting how a seemingly false or unreliable poll caused significant movement on an event contract market and suggesting that such poll could have been, or at least could be, created to cause such market movement; further arguing that such false polls can have a real and detrimental effect on elections).

⁴⁰ Such individuals and entities could include, for example, Congressional campaign volunteers, consultants to Congressional campaigns, or donors or other supporters of political parties or individual Congressional candidates.

well-suited, with two members of the House of Representative stating in a joint comment letter that “because the CFTC is not equipped or authorized to enforce election laws, the prospect of the Commission assuming the role of an ‘election cop’ raises very serious concerns about the misalignment of such a role with the CFTC’s historic mission and mandate as established by Congress.”⁴¹

Therefore, the Commission FINDS that:

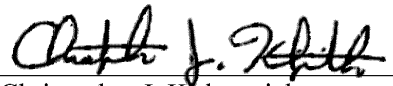
Pursuant to section 5c(c)(5)(C)(i) of the Commodity Exchange Act and Commission Regulation 40.11, the Congressional Control Contracts: (1) involve gaming and activity that is unlawful under State law; and (2) are contrary to the public interest.

Accordingly, IT IS HEREBY ORDERED THAT:

Pursuant to CEA section 5c(c)(5)(C)(ii) and Commission Regulation 40.11(a)(1), the Congressional Control Contracts are prohibited and shall not be listed or made available for clearing or trading on or through Kalshi.

The provisions of this Order shall be effective as of this date.

By the Commission.



Christopher J. Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission

Date: September 22, 2023

⁴¹ Comment Letter of Reps. Sarbanes and Raskin at 3.

**DCM Products****UNITED STATES****COMMODITY FUTURES TRADING COMMISSION**

Submitter Information	
Organization Name Kalshi	
Organization Type DCM	Organization Acronym KEX
Submitted By xsottile	Email Address xsottile@kalshi.com
Cover Sheet	
Submission Number 2306-1218-0838-36	Submission Date 6/12/2023 6:08:38 PM ET
Submission Type 40.2(a) Product Certification	
Submission Description Will chamber of Congress be controlled by party for term?	
<input checked="" type="checkbox"/> Request Confidential Treatment	
Registered Entity Identifier Code	
Intended Listing Date 6/27/2023	
<input type="checkbox"/> Listing Date Unknown	
Product Information	
Official Product Name Will chamber of Congress be controlled by party for term?	
Product Type Swap (Binary Option)	Settlement Method Cash Settlement
Product Group Event	Product Sub Group Binary Option
<input type="checkbox"/> Novel Product Subject to Jurisdictional Determination	
Product Publication Website	
Documents	
CONTROL CONTRACT for posting.pdf CONTROL CONTRACT confidential.pdf (Confidential Treatment Requested) Additional Materials -- Counsel Letters.pdf Additional Materials -- Pham dissent.pdf	
Request For Confidential Treatment - Detailed Written Justification	

Confirmation Number
2306-1218-0838-36Submitted
6/12/2023 6:08:38 PMROA0000024
JA00024

CFTC Kalshi FOIA Request (contract filing) (latest).pdf

KalshiEX LLC

June 12, 2023

SUBMITTED VIA CFTC PORTAL

Secretary of the Commission
Office of the Secretariat
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: KalshiEX LLC - Commission Regulation 40.2(a) Notification Regarding the Initial Listing of the “Will <chamber of Congress> be controlled by <party> for <term>?” Contract

Dear Sir or Madam,

Pursuant to Section 5c(e) of the Commodity Exchange Act and Rule 40.2(a) of the regulations of the Commodity Futures Trading Commission, KalshiEX LLC (Kalshi or Exchange) hereby notifies the Commission that it is self-certifying the “Will <chamber of Congress> be controlled by <party> for <term>?” contract (Contract) for Commission review and approval. The Exchange intends to list the contract on a biannual basis (every two years). The Contract’s terms and conditions (Appendix A) include the following strike conditions:

- **<party> (the political party)**
- **<chamber of Congress> (the House or the Senate)**
- **<term> (e.g. the 119th Congress)**

Along with this letter, Kalshi submits the following documents:

- A concise explanation, analysis and background of the Contract;
- Certification;
- Appendix A with the Contract’s Terms and Conditions;
- Confidential Appendices with further information; and
- A request for FOIA confidential treatment.

If you have any questions, please do not hesitate to contact me.

Sincerely,

Xavier Sottile
Head of Markets
KalshiEX LLC
xsottile@kalshi.com

KalshiEX LLC

KalshiEX LLC

KalshiEX LLC

Official Product Name: Will <chamber of Congress> be controlled by <party> for <term>?

Rulebook: CONTROL

Kalshi Contract Category: Political Decision

Control of Congress

June 12, 2023

CONCISE EXPLANATION AND ANALYSIS OF THE PRODUCT AND ITS COMPLIANCE WITH APPLICABLE PROVISIONS OF THE ACT, INCLUDING CORE PRINCIPLES AND THE COMMISSION'S REGULATIONS THEREUNDER

Pursuant to Commission Regulation 40.2(a)(3)(v), the following is a concise explanation and analysis of the product and its compliance with the Act, including the relevant Core Principles, and the Commission's regulations thereunder.

I. Introduction

The "Will <chamber of Congress> be controlled by <party> for <term>?" Contract (Contract) is a contract relating to the partisan control of Congress.

Further information about the Contract, including an analysis of its risk mitigation and price basing utility, as well as additional considerations related to the Contract, is included in Confidential Appendices.

Pursuant to Section 5c(c) of the Act and CFTC Regulations 40.2(a), the Exchange hereby certifies that the listing of the Contract complies with the Act and Commission regulations under the Act.

General Contract Terms and Conditions: The Contract operates similar to other event contracts that the Exchange lists for trading. The minimum price fluctuation is \$0.01 (one cent). Price bands will apply so that the Contract may only be listed at values of at least \$0.01 and at most \$0.99. The Contract has a one dollar notional value and has a minimum price fluctuation of \$0.01 to be consistent with other Kalshi contracts. Contracts must be purchased in multiples of 5,000 contracts per order. This order size is an appropriate amount for large institutions to mitigate risk and is consistent with other futures and derivatives products. The Exchange has further imposed position limits (defined as maximum loss exposure) as described in Appendix A. As outlined in Rule 5.12 of the Rulebook, trading shall be available at all times outside of any maintenance windows, which will be announced in advance by the Exchange. Members will be charged fees in accordance with Rule 3.6 of the Rulebook. Fees are charged in such amounts as may be revised from time to time to be reflected on the Exchange's Website. Additionally, as

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outlined in Rule 7.2 of the Rulebook, if any event or any circumstance which may have a material impact on the reliability or transparency of a Contract's Source Agency or the Underlying related to the Contract arises, Kalshi retains the authority to designate a new Source Agency and Underlying for that Contract and to change any associated Contract specifications after the first day of trading. That new Source Agency and Underlying would be objective and verifiable. Kalshi would announce any such decision on its website. All instructions on how to access the Underlying are non-binding and are provided for convenience only and are not part of the binding Terms and Conditions of the Contract. They may be clarified at any time. Furthermore, the Contract's payout structure is characterized by the payment of an absolute amount to the holder of one side of the option and no payment to the counterparty. During the time that trading on the Contract is open, Members are able to adjust their positions and trade freely. After trading on the Contract has closed, the Expiration Value and Market Outcome are determined. The market is then settled by the Exchange, and the long position holders and short position holders are paid according to the Market Outcome. In this case, "long position holders" refers to Members who purchased the "Yes" side of the Contract and "short position holders" refers to Members who purchased the "No" side of the Contract. If the Market Outcome is "Yes" (please see Appendix A for the conditions upon which the Market Outcome is "Yes"), then the long position holders are paid an absolute amount proportional to the size of their position and the short position holders receive no payment. If the Market Outcome is "No," then the short position holders are paid an absolute amount proportional to the size of their position and the long position holders receive no payment. Specification of the circumstances that would trigger a Market Outcome of "Yes" are included below in the section titled "Payout Criterion" in Appendix A. The Expiration Date of the Contract is designed to account for multiple possible contingencies regarding the timing of the determination of control of a given chamber of Congress.

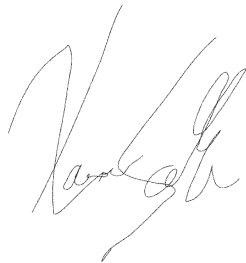
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**CERTIFICATIONS PURSUANT TO SECTION 5c OF THE COMMODITY EXCHANGE
ACT, 7 U.S.C. § 7A-2 AND COMMODITY FUTURES TRADING COMMISSION RULE
40.2, 17 C.F.R. § 40.2**

The Exchange certifies that this submission (other than those appendices for which confidential treatment has been requested) has been concurrently posted on the Exchange's website at <https://kalshi.com/regulatory/filings>.

Should you have any questions concerning the above, please contact the exchange at ProductFilings@kalshi.com.



By: Xavier Sottile
Title: Head of Markets
Date: June 12, 2023

KalshiEX LLC

ROA0000029
JA00029

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Attachments:

Appendix A - Contract Terms and Conditions

Appendix B - Trading Prohibitions

Index of confidential appendices

Confidential appendices

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APPENDIX A – CONTRACT TERMS AND CONDITIONS

**Official Product Name: Will <chamber of Congress> be controlled by <party> for <term>?
Rulebook: CONTROL**

KalshiEX LLC

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KalshiEX LLC

CONTROL

Scope: These rules shall apply to this contract.

Underlying: The Underlying for this Contract is the political party membership of each Member of Congress for <term>, as well as the political party membership of the Speaker of the House and the political party membership of the President Pro Tempore, according to congress.gov. The Exchange will also consider the caucus decisions of Independent members. Revisions to the Underlying made after Expiration will not be accounted for in determining the Expiration Value.

Source Agency: The Source Agency is congress.gov.

Type: The type of Contract is an Event Contract.

Issuance: The Contract is based on the outcome of a recurrent data release, which is issued for each new term of Congress. Thus, Contract iterations will be issued on a recurring basis, and future Contract iterations will generally correspond to the next election cycle.

<chamber of Congress>: refers to a chamber of the United States Congress. It can take the value of “U.S. House of Representatives” or “U.S. Senate”.

<term>: refers to a term of the United States Congress. A term of Congress begins and ends every two years.

<party>: refers to a political party.

Payout Criterion: The Payout Criterion for the Contract encompasses the Expiration Values where the leader of <chamber of Congress> is a member of <party> on the Expiration Date. In the case of the U.S. House of Representatives, this is the Speaker of the House. In the case of the U.S. Senate, this is the President Pro Tempore.

Minimum Tick: The Minimum Tick size for the referred Contract shall be \$0.01.

Position Limit: The Position Limit for the \$1 referred Contract shall be as follows:

- The Position Limit for Individuals shall be \$125,000 per Member; and \$250,000 for those with demonstrated established economic hedging need
- The Position Limit for Entities shall be \$5,000,000 per Member; and \$10,000,000 for those with demonstrated established economic hedging need

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- The Position Limit for Eligible Contract Participants (“ECP”) shall be \$50,000,000 per Member; and \$100,000,000 for those with demonstrated established economic hedging need

Established economic hedging need may be demonstrated to Kalshi according to the means and methods established by Kalshi. Whether a member has demonstrated that it has a sufficiently established economic hedging need is determined solely at Kalshi’s discretion.

Last Trading Date: The Last Trading Date of the Contract will be the same as the Expiration Date. The Last Trading Time will be the same as the Expiration Time.

Settlement Date: The Settlement Date of the Contract shall be no later than the day after the Expiration Date, unless the Market Outcome is under review pursuant to Rule 7.1.

Expiration Date: The Expiration Date of the Contract shall be February 1 in the year that <term> begins.

Expiration time: The Expiration time of the Contract shall be 10:00 AM ET.

Settlement Value: The Settlement Value for this Contract is \$1.

Order Size: Contracts must be purchased in multiples of 5,000 contracts per order.

Expiration Value: The Expiration Value is the value of the Underlying as documented by the Source Agency on the Expiration Date at the Expiration time.

Contingencies: Before Settlement, Kalshi may, at its sole discretion, initiate the Market Outcome Review Process pursuant to Rule 6.3(c) of the Rulebook. Additionally, as outlined in Rule 7.2 of the Rulebook, if any event or any circumstance which may have a material impact on the reliability or transparency of a Contract’s Source Agency or the Underlying related to the Contract arises, Kalshi retains the authority to designate a new Source Agency and Underlying for that Contract and to change any associated Contract specifications after the first day of trading.

Trading Prohibitions: In addition to the general trading prohibitions found in Kalshi’s Rulebook, the following are prohibited from trading this contract:

- Candidates for federal or statewide public office. Please note that this prohibition applies to more than just candidates for Congress.
- Paid campaign staffers on Congressional campaigns.
- Paid employees of Democratic and Republican Party organizations, such as the

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Democratic Congressional Campaign Committee or the Republican National Committee.

- Paid employees of Political Action Committees (PACs) and “Super PACs” (independent expenditure only political committees).
- Paid employees of major polling organizations. This prohibition does not apply to all employees of an organization that contains a polling division (e.g. the prohibition does not apply to all employees of Quinnipiac University despite the presence of Quinnipiac University’s polling division). The Exchange shall determine which polling organizations constitute “major” and may modify that determination at any time.
- Existing members of Congress, including those not running for re-election.
- Existing paid staffers of members of Congress.
- Household members and immediate family members (siblings, children, and parents) of any of the above.
- Any of the above listed institutions themselves.

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APPENDIX B – TRADING PROHIBITIONS

In addition to the general prohibition against trading on material nonpublic information, the Exchange will be instituting additional prohibitions for trading the CONTROL contract. The following individuals and entities will be prohibited from trading:

- Candidates for federal or statewide public office. Please note that this prohibition applies to more than just candidates for Congress.
- Paid campaign staffers on Congressional campaigns.
- Paid employees of Democratic and Republican Party organizations, such as the Democratic Congressional Campaign Committee or the Republican National Committee.
- Paid employees of Political Action Committees (PACs) and “Super PACs” (independent expenditure only political committees).
- Paid employees of major polling organizations. This prohibition does not apply to all employees of an organization that contains a polling division (e.g. the prohibition does not apply to all employees of Quinnipiac University despite the presence of Quinnipiac University’s polling division). The Exchange shall determine which polling organizations constitute “major” and may modify that determination at any time.
- Existing members of Congress, including those not running for re-election.
- Existing paid staffers of members of Congress. Household members and immediate family members (siblings, children, and parents) of any of the above.
- Any of the above listed institutions themselves.

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INDEX OF CONFIDENTIAL APPENDICES

Appendix C (Confidential) - Risk Mitigation and Price Basing Utilities
Appendix D (Confidential) - Commission Jurisdiction and the Special Rule for Event Contracts
Appendix E (Confidential) - Other Considerations for the Public Interest
Appendix F (Confidential) - Source Agency
Appendix G (Confidential) - Compliance with Core Principles
Appendix H (Confidential) - Compliance with the Contract Vetting Framework
Appendix I (Confidential) - Directly Addressing Commission Questions
Appendix J (Confidential) - Comparison with Nadex Submission
Appendix K (Confidential) - Additional Core Principle 3 Considerations
Appendix L (Confidential) - The Importance and Salience of Climate Risk to Political Risk Contracts
Appendix M (Confidential) - Additional Materials

KalshiEX LLC - Confidential Treatment Under Regulations 40.8 and 145.9 Requested

APPENDIX C (CONFIDENTIAL) – RISK MITIGATION AND PRICE BASING UTILITIES

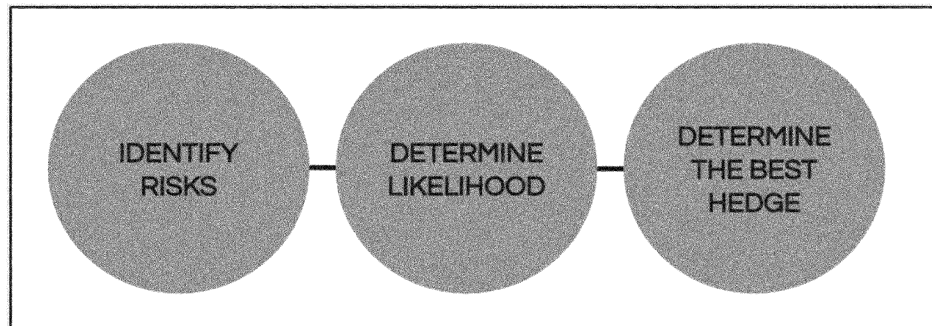
The following sections will provide an explanation of the hedging utility of this contract.

- First, in section A, we will establish how firms generally make risk management decisions and how hedging fits into those decisions;
- Section B sets forth contract specific analysis, which will establish how political control contracts fit into the risk management framework described in section A. Section B also presents an analogy to climate risk hedging;
- Section C highlights the extensive evidence that demonstrates the impacts of elections are not merely hypothetical, but an actual phenomenon that presents tangible financial risk for firms;
- Section D presents several extensive illustrations of how the CONTROL contract will be used for hedging;
- Section E offers analogies to similar products;
- Section F explains how the Contract's specifications enhance its hedging utility for many market participants;
- Section G discusses the price basing utility of the contract; and
- Section H addresses miscellaneous comments that touch on the contract's hedging and price basing functions.

A. General risk management

Businesses face a panoply of potential harms that will affect and impact their value. These potential harms are risks. Risks include valuation risk (the value of the business's services or asset's decline), funding risk (access to credit or other funding declines), and operational risks (possible disruptions or errors in the production process that undermine their earnings), among many others. Each one of these general categories of risk will manifest and impact each business according to the business's unique activities, profile, composition, *et cetera*. In addition to these examples, there are many more categories of risks, including strategic risks (e.g., getting outcompeted by a competitor), reputation risks, liability risks and beyond.

There are three steps that businesses generally follow when they are managing the risk of harm. The first step is to identify the risk's impact, meaning the various places where the business can suffer, such as its income or valuation. The second step is for the business to assess how likely it is that the potential harms will materialize, and how severe or acute will the impacts of these harms be. In order to do that, the business must consider the factors that can affect the likelihood and severity of the risks. These include market conditions and all related factors that can have a bearing on the potential harm.



This three-step process characterizes an appropriate risk management framework. It works for all manners of risks.

To illustrate, a business might identify that a decline in profit margin is a harm that it faces. One of the many factors that could cause this harm is changes in demand for its product that will change what it can charge. The business won't stop there, though. It will identify what trends or events will create a change in demand for its product. For example, the business will consider what market forces impact its core customer base. A slowdown in that sector might have a corresponding downward impact on the demand for the business's product. To illustrate, consider a builder of extra-large river barges in the upper Midwest. They know that "changes in demand" impact their risk, but they need to know what affects demand. Naturally, they look to key factors such as lower grain yield in the upper Mississippi River Valley (as lower grain yield may mean lower need for river barges). Both of these are factors that will impact the acuteness of the risk, *i.e.*, whether the harm is likely to happen and how severe it will be if it does happen. As a result, they may purchase short contracts on grain futures in order to hedge their risk.

Similarly, many businesses face potential harms that are impacted by inflation. Inflation can impact nearly all term contracts, impacting the business's real costs. For instance, a firm locked into a 10-year commercial lease on their office space will see lower real costs as a result of inflation than with a shorter lease. However, if the company is also a supplier and has locked in their sales contracts (e.g., they have agreed to sell 100,000 tons of fertilizer at \$900/ton), then the real value of those sales decline and inflation will harm them. Of course, inflation affects many other risks as well. Higher inflation raises the probability that the Federal Reserve raises its target interest rates, which tends to substantially reduce stock valuations and the value of assets.¹ Inflation is just one of many examples of factors that impact the likelihood and severity of

¹ The price of a stock is often considered the "discounted present value of future dividends". When the interest rate (a.k.a. the discount rate) goes up, then the present value of future dividends declines and thus the stock value declines. In simpler terms, when the interest rate goes up, it raises the relative value of present money over future profit. So an asset that incurs costs in the short-run but profits in the long-run is less valuable when interest rates are higher. A stock—which costs money in the short run but may generate dividends in the long-run—is thus less valuable when interest rates rise. That's doubly true for "growth stocks" that may be generating no profits now, but may generate them 5-10 years from now.

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potential harms. To mitigate those risks, they may seek to purchase any one of many inflation hedges, such as inflation swaps, inflation-protected Treasuries, or inflation event contracts.

B. Application to political control contracts

Political control represents another factor that could impact a company's risk profile, much like inflation. Firms use the same risk management strategy as before. A company first identifies harms—operational, reputational, valuation, credit, and more—and then identifies the ways those risks could change. The aforementioned fertilizer company may be purchasing fertilizer inputs like potash from other countries (potash is often found in Russia, Belarus, and China) and identify their largest operational risk as disruption in the global potash supply chain. They further identify that changes in congressional political control could increase the probability that the supply chain is disrupted since different Congresses may take different approaches to tariffs, sanctions and other trade-related policies. The election of a new Congress skeptical about status quo policy will immediately impact their business by reducing the expected revenues of current investments, new investments, and making partners and investors skittish. As a result, changes in political control directly increases (or decreases) the firm's operational risks.

Perhaps the clearest example of this description of risk management comes from the CFTC's report "Managing Climate Risk in the U.S. Financial System" ("CFTC Climate Report").² In Figure 2.1 (shown below) and expounded upon at length in Chapter 2 of the report, the report discusses transition risk, which is defined as the "risk associated with the uncertain financial impacts that could result from a transition to a net-zero emissions economy". They note that transition risk implicates "market, credit, policy, legal, technological, and reputational risks" for firms and must be a part of any honest risk assessment. Most importantly, the report specifically identifies how transition risks "could arise, for example, from changes in policy" along with other factors such as "technological breakthroughs, and shifts in consumer preferences and social norms".

As the Financial Stability Oversight Council corroborates, policy changes (along with technological change and consumer preference changes) "especially if delayed or uneven in application and therefore requiring more abrupt economic shifts—may lead to sharp changes in the values of certain assets or liabilities, impacting nonfinancial activity and the financial sector."³ As a draft rule from the Federal Reserve Board states, "Financial institutions with sound risk management practices employ a comprehensive process to identify emerging and material

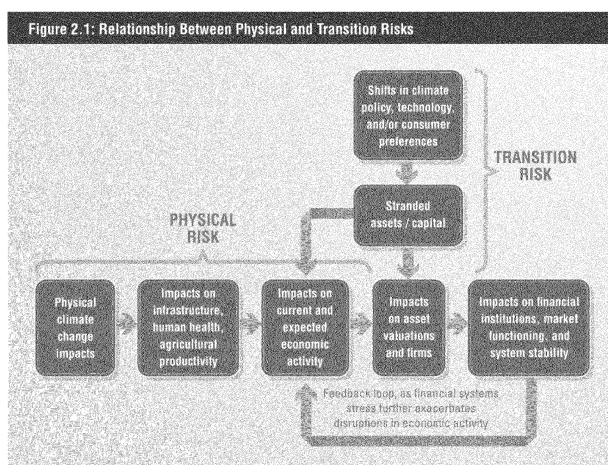
² Commodity Futures Trading Commission. 2020. "Managing Climate Risk in the U.S. Financial System". <https://www.cftc.gov/sites/default/files/2020-09/9-9-20%20Report%20of%20the%20Subcommittee%20on%20Climate-Related%20Market%20Risk%20-%20Managing%20Climate%20Risk%20in%20the%20U.S.%20Financial%20System%20for%20posting.pdf>

³ Financial Stability Oversight Council. 2021. "Report on Climate-Related Financial Risk" <https://home.treasury.gov/system/files/261/FSOC-Climate-Report.pdf>

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risks related to the financial institution's business activities. The risk identification process should include input from stakeholders across the organization with relevant expertise (e.g., business units, independent risk management, internal audit, and legal). Risk identification includes assessment of climate-related financial risks across a range of plausible scenarios and under various time horizons.”⁴ As both reports show, firms *must* consider all of the risks facing their businesses, and the only honest and accurate way to do so is to consider the way changes in policy affect those risks. This analogy is drawn out further in Appendix L.



Commodity Futures Trading Commission. 2020. “Managing Climate Risk in the U.S. Financial System”. Page 12

C. Evidence of election risk and hedging need

Elections clearly impact myriad cash flows and assets. Political parties vie for office with credible commitments to affect public policy. As a consequence, elections portend risk for many firms with politically exposed cash flows and assets. The financial press frequently reports on how elections (and even changes in election polling) affect the prices of financial assets well before a new Congress has even been seated.⁵ Election hedging specifically is also often referenced in the financial press.⁶ Below, we present evidence from academic and private

⁴ Board of Governors of the Federal Reserve System. 2022. “Principles of Climate-Related Financial Risk Management for Large Financial Institutions.” <https://www.federalregister.gov/documents/2022/12/08/2022-26648/principles-for-climate-related-financial-risk-management-for-large-financial-institutions>

⁵ There are scores of articles which could serve as examples, but some are: Noel Randewich. 2020. “S&P 500 futures rise as U.S. election suggests less regulatory risk.” *Reuters*; Myra P. Saefong. 2020. “Here’s how the U.S. presidential election could shake up the oil market.” *Marketwatch*; Matthew Weaver. 2020. “Congressional elections could impact commodity prices most, expert says.” *Capital Press*.

⁶ There are scores of articles which could serve as examples, but some are: Weismann, Jordan. “Wall Street Says You Should Short Mexico to Prepare for Trump.” 2016. *Slate*; Brice, Jessica, and Cota, Isabella. “How Hedging and a Certain Someone Upended the Year of the Peso.” 2016. *Bloomberg*.

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research, firm testimony, and the comment file on Kalshi's previous submission detailing the existence of election risk and a core use case for Kalshi's Contract .

Academic research has consistently found that changes in political control result in changes to the prices of traded assets. For example, researchers Erik Snowberg, Justin Wolfers, and Eric Zitzewitz used a variety of prediction markets (including one permitted by the Commission, Iowa Electronic Markets) to establish a relationship between the odds of a given party's success in Congressional midterms and financial markets/indicators.⁷ They found that there was a consistent link between changes in expectations of who would control Congress and the prices of equities, government bonds, and the exchange rates between the U.S. dollar and foreign currencies. The fact that financial markets utilize political control as a pricing factor demonstrates that not only are elections something that should be hedged, but that firms are already hedging and repricing assets on public markets. If this is the case, there is no case to argue that elections are not "sufficiently predictable" events to hedge; the market is already doing so.

That same team looked at high-frequency trading data immediately following the release of (what turned out to be inaccurate) exit poll data which briefly caused a major change in the odds of a Democratic victory in 2004. Such a sudden spike during what is normally a quiet trading period allowed the researchers to isolate the effects of the changes in political expectations from other economic events during the same period. They concluded that markets expected a Republican victory to result in higher equity prices, interest rates, oil prices, and a stronger dollar than a Democratic one.⁸ They reperformed that analysis in 2016, where they found that markets anticipated that a Republican victory would reduce the value of the S&P 500, foreign stock markets, reduce oil prices, and lead to a significant decline in the Mexican Peso, while also increasing future market volatility compared to a Democratic win.⁹ A similar study in 2008 found that Democratic politicians polling higher than Republican ones was better for equity markets.¹⁰

Similarly, Northwestern professor Seema Jayachandran used a natural experiment to study the effects of changes in the partisan control of Congress.¹¹ In 2001, Vermont Senator James Jeffords switched parties from Republican to Democrat, shifting control of the Senate. In what she called "the Jeffords effect", the equity valuations of firms that donated to Republicans decreased by 0.4%, while the equity valuations of firms that donated to Democrats increased by 0.1%, again indicating the marketplace's belief that Congressional control has real, predictable consequences

⁷ Erik Snowberg, Justin Wolfers and Eric Zitzewitz. "Party Influence in Congress and the Economy." 2007.

⁸ Erik Snowberg, Justin Wolfers and Eric Zitzewitz. "Partisan Impact on the Economy". *Journal of Economic Perspectives*. 2004.

⁹ Justin Wolfers and Eric Zitzewitz. 2016. "What do financial markets think of the 2016 election?"

¹⁰ Demissew Diro Ejara, Raja Nag, and Kamal P. Upadhyaya, 2012. "Opinion polls and the stock market: evidence from the 2008 US presidential election." *Applied Financial Economics*.

¹¹ Seema Jayachandran. 2006. "The Jeffords Effect". *Journal of Law and Economics*.

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on firm valuations. Brown University economist Brian Knight found that “under a Bush administration, relative to a counterfactual Gore administration, Bush-favored firms are worth 3% more and Gore-favored firms are worth 6% less, implying a statistically significant differential return of 9%”.¹² Economist Andrea Mattozi found by regressing Bush- or Gore-affiliated portfolios against surprising poll results, “an increase in the probability of a Bush victory from 50 to 51 percent, increases the annual expected excess return of the Bush portfolio by 25 percent and decrease[s] the annual expected excess return of the Gore portfolio by 35 percent”.¹³ This finding—that changes in the expectations of who controls government affects the prices of assets—have been replicated time and time again.¹⁴

Financial assets are derivatives of real economic cash flows and commodities. For example, the stock of a company is representative of that company’s value, a function of its costs and cash flows. Thus, market participants are imputing elections’ impacts into those assets, suggesting markets believe that elections create economic risks, but those impacts are predictable enough to spend money repricing assets and hedging even in advance of policy decisions.

Consequently, banks regularly inform their clients as to how Congressional elections may impact their clients’ extant risks. In 2020, investment bank research divisions offered projections about the economic and financial impacts of various political outcomes. For example,

- Goldman Sachs’s chief economist stated publicly that full Democratic control of government would cause the bank to upgrade their earnings forecast by sharply increasing the probability that a large fiscal stimulus bill would become law.¹⁵ Full Democratic control would also, according to the bank’s insights, “likely include a stimulus package in Q1, followed by infrastructure and climate legislation. In this scenario, we would expect legislation expanding health and other benefits, financed by tax increases, to pass.”¹⁶

¹² Brian Knight. 2006. “Are policy platforms capitalized into equity prices? Evidence from the Bush/Gore 2000 Presidential Election” *Journal of Public Economics*.

¹³ Andrea Mattozzi. 2005. “Can we insure against political uncertainty? Evidence from the U.S. stock market”.

¹⁴ Examples abound, but also include, in addition to the research already discussed: Frederico Belo, Vito D. Gala, and Jun Li. 2013. “Government spending, political cycles, and the cross section of stock returns.” *Journal of Financial Economics*; and Kyle Handley and Nuno Limao. 2015. “Trade and investment under policy uncertainty: theory and firm. evidence.” *American Economic Journal: Economic Policy*; Bryan Kelly, Lubos Pastor, and Pietro Veronesi. 2016. “The price of political uncertainty: Theory and evidence from the option market.” *The Journal of Finance*.

¹⁵ Matthew Fox. 2020. “Goldman’s chief economist breaks down why a Biden-led blue wave would prompt an upgrade in growth forecasts”. *Business Insider*.

¹⁶ Thomas Franck. 2020. “Goldman Sachs says Democratic sweep would unleash ‘substantially’ more stimulus.” CNBC.

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- Morgan Stanley also cited the chance of stimulus along with infrastructure spending and corporate tax changes as a vehicle for a “blue wave” leading to a weaker dollar, lower interest rates, stronger GDP growth and lower bond prices.¹⁷¹⁸
- JP Morgan Chase projected that a Democratic victory would lead to a rally in ‘left-behind’ equities, such as “European cyclicals, value, China-exposed stocks and renewables.”¹⁹
- Bank of America provided roadmaps for each type of partisan outcome (e.g. one party controls all of government, divided government, et cetera). They wrote that full Democratic control of government would lead to \$2-2.5 trillion in stimulus compared to a Biden win with a divided Congress (\$0.5-1 trillion) or a Trump win with a divided Congress (\$1.5-2 trillion). They also detailed impacts to specific sectors, like businesses exposed to Chinese trade, in each scenario.²⁰
- UBS published a report noting partisan outcomes for policy and the economy, and recommended investors specifically focus on candidates’ policy commitments with regards to politically-sensitive industries like energy, health care, financials, and the environment. They noted that their investors should consider how the S&P 500 has performed best in environments where Republicans win, and their clients should make portfolio appropriate adjustments.
- Moody Analytics—not an investment bank, but a credit rating agency with a market research division—explicitly estimated that Democratic control of government would result in 4.2% growth between 2020-2024, compared to 3.1% under a Republican control scenario.²¹ They similarly projected a one percentage point lower unemployment rate and a 0.6 percentage point higher S&P 500 under a Democratic sweep.

This research is distributed, at great cost, to major financial institutions, especially capital pools like hedge funds and pension funds. This behavior strongly suggests that firms care a great deal about the specific impacts of elections on their assets, and take action to hedge their positions in advance. This was corroborated in a comment letter provided by a Managing Director of JPMorgan Chase. He wrote,

At JPMorgan, election risk is one of the largest risks our clients face, and they frequently engage us proactively on how to minimize it (hedge it, in other words). We work with and advise our clients on how to avoid that risk in their portfolios, especially when a client’s cash flows or investments are very politically sensitive (for example, those in the coal industry are very concerned regarding election outcomes and policy expectations).

¹⁷ Morgan Stanley. 2020. “A Revised Guide to Economic Policy Paths & Market Impacts”.

¹⁸ Morgan Stanley. 2020. “2020 US Election Preview: 5 Themes to Watch for Investors.”

¹⁹ Ksenia Galouchko. 2020. “JPMorgan Says Biden Victory Could Mark a Stock Market Shift.” Bloomberg.

²⁰ Bérengère Sim. 2020. “Bank of America wrote a massive 92-page report on the election's impact — here’s what investors need to know.” Financial News.

²¹ Moody’s Analytics. 2020. “The Macroeconomic Consequences: Trump vs. Biden”.

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Since clients have different risk profiles, we do extensive research to fine-tune how these risks add up in our clients' positions. Our division employs a team of economists, at service to our partners, whose role in election years is heavily to research election probabilities as well as the impact election outcomes will have on equities and other investment products. We frequently host discussions with experts and clients on the relevant risks (including one coming up this week!) and publish research for both clients and the public.²²

In addition, businesses themselves often note electoral outcomes as an important factor in their value. In Q3 2020, more than one-third of company quarterly earnings conference calls used the term 'election' in the context of their financial assessments and projections.²³ On these calls, concerns were most frequently raised regarding regulatory changes that would impact business, as well as tax reform and additional potential fiscal stimulus. Earnings calls also frequently included discussions regarding the economic and business impacts of different political control outcomes (e.g., a "blue wave", divided government, et cetera). Consider this fall 2020 testimony from Thomas Peterffy, Chairman of Interactive Brokers, a brokerage firm:

Well, in the last couple of weeks, we do notice some moderation in activity, and -- which would be expected as we come up to the election. And then, of course, I think it will pick up when the results come out, especially if the Senate goes Democratic, I expect that people will start taking the long-term gains because of the expected 43% long-term capital gains tax rate. And then of course, we are looking further down the road, more and more spending that will result in asset inflation, including higher and higher stock prices.

The marketplace's expectations of the impacts of changes in political control are so credible that the Federal Reserve uses them when making monetary policy decisions. For example, during the December 2012 Federal Open Market Committee meeting, Simon Potter, the Federal Reserve's Head of Economic Research said:

The outcome of the election reinforced investors' expectations for a continuation of highly accommodative monetary policy...Some market participants also believe that there is an increased chance of housing policy changes following the election, which would increase refinance activity and origination volumes associated with credit-constrained borrowers.²⁴

Commenters on Kalshi's previous submission overwhelmingly argued in favor of the Contract's risk mitigation value. This included industry leaders (such as Jorge Paulo Lemann, Christopher Hehmeyer, Ron Conway, Seth Weinstein) and owners of politically sensitive businesses (such as those of Continental Grain Company, Nabis, Greenwork, Upsolve) who specifically discussed

²² Public Comment by Angelo Lisboa. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=696666>.

²³ John Butters. 2020. "More than one third of S&P 500 companies are discussing the election on Q3 earnings calls." Factset.

²⁴ Meeting of the Federal Open Market Committee. December 11–12, 2012.

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hedging use cases for their companies.²⁵ This included Greg Sirotek, the co-founder and CEO of Moneytree Power, a startup dedicated to installing solar power:

Congress has an incredible influence over the future of the zero-carbon energy industry, particularly the solar industry...Given the respective differences in the two parties' positions on the importance of climate change mitigation, renewable energy development and the deficit, the risk profiles depending on which party is in power is vast. An event contract which pays out on the basis of Congressional control would allow our business to manage this previously unhedged risk.²⁶

Jorge Paulo Lemann, a founder at 3G Capital and a Board member of firms like AB-InBev and Kraft Heinz (some of the largest participants in traditional agricultural futures), wrote:

These statements [claims that there are no hedging or price basing use cases for election contracts] are inconsistent with the preponderance of the academic research on the subject and is inconsistent with the actual experience of anyone who has ever operated a business in or with the United States or traded on the global commodity markets. Experience and empirical observation show that elections have consequences, and these consequences directly create risk that can be hedged, and are factored into pricing commodities, financial assets, and services.²⁷

Hehmeyer, former Chair of the National Futures Association and Board Member of the Futures Industry Association, added that many are affected regardless of policy outcomes:

For example, media personalities and companies face risk from Congressional control and elections. Early professionals hoping to work on Capitol Hill know there are far more positions available if their preferred party is victorious, as there are more Congressional offices and committee positions for them to staff. A consultancy that specializes in specific topic areas (for example, a green energy consultancy) may know the demand for their services will decline in anticipation that their issue of expertise is less likely to be operative under a split Congress. These risks occur regardless of the legislation that actually passes. There are billions of dollars at risk surrounding the outcome of Congressional control and elections. These risks can reasonably be expected to be managed through this contract on Congressional control.²⁸

Although some commenters claimed election outcomes aren't predictable enough to be a useful hedge, that in no way contradicts or even diminishes those who say the opposite. At most, those commenters do not see hedging utility for themselves. They cannot credibly say that all the firms who identified how they would use the contracts for hedging and managing their risk are mistaken or deficient in their ability to recognize risk and potential tools to manage or mitigate that risk. It would be arbitrary for the Commission to listen only to the few who assert that there

²⁵ Public comments 69668, 69715, 69667, 69683, 69678, 69619, 69684, 69717, 69714, 69718, 69727, 69707, 69677, 69655.

²⁶ Public Comment by Greg Sirotek. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70751>.

²⁷ Public Comment by Jorge Paulo Lemann. Available at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69684>.

²⁸ Public Comment by Christopher Hehmeyer. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69717&SearchText=christopher>.

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is no hedging use case for anyone when most others who state that they would use the product for themselves or their business.

Thus, it is clear that businesses consider political control an important risk to be hedged. This reality is recognized by the CFTC in the CFTC's Climate Report and the aforementioned FSOC report. It noted that, "uncertainty associated with policy risk is already penalizing oil companies that are investing in undeveloped fossil fuel reserves" and "financial market participants are already looking for ways to manage transition risk in their investment portfolios."²⁹ The partisan makeup of Congress is a critical factor of policy risk that Kalshi's Contract addresses.

Even if the above evidence was not clear, the market is best positioned to make that determination, not the Commission or Kalshi. If that risk is too tangential, then the product will be a commercial failure. With a contract designed for hedging, such as this contract with its minimum order size and increased position limits, the market and market participants will be able to determine their own risk management strategies, and whether the contract is a necessary component of their strategies or not. That is a decision that is appropriately left to the participants to decide for themselves.

D. How the CONTROL contract can be used to hedge political risk in practice

Note that the CONTROL contract is not a panacea that can hedge all risks. It is not appropriate for all market participants, and it is not appropriate for all risks. The CONTROL contract is appropriate for businesses that face risk impacted by partisan political control of Congress. For those businesses, the CONTROL contract can be an important hedge and part of their overall risk management process. A typical business that has risks that are impacted by political control will have risks that are appropriately hedged by the CONTROL contract, as well as risks that are not. The following examples illustrate the risk management analysis a typical business will follow, with risks that are impacted by political control and risks that are not, in order to illustrate how the contract fits into a broader risk management strategy that a firm may undertake.

Though the comment file (and other evidence discussed in Section C above) provide many tangible examples of firms describing the risks they are subject to and would use the Contract to mitigate, Section D will include detailed descriptions of firms' hedging. Consider an enhanced geothermal systems company producing process heat for industrial processes (e.g. paper mills). The business will identify the potential harms that the company faces. Naturally, there are many operational risks (what if a rig breaks?), but those are hardly the only risks they face. Some other risks are enumerated below:

²⁹ Commodity Futures Trading Commission. 2020. "Managing Climate Risk in the U.S. Financial System".

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- Increases in transportation costs, which could affect the cost of transporting specialized boring equipment. This may occur due to increases in trucking rates or changes in gas/diesel prices. For illustration, let us say that every 1% increase in transportation costs costs the firm \$200,000.
- Changes in the price they can sell their goods, which could occur due to rising energy prices or government rebates. For example, suppose a 1% increase in energy costs increases firm profits by \$500,000.
- A shift in the demand curve for their services. There is a subtle but important distinction between changes in services demand due to lower prices (which in economic terms would be considered a move along the same demand curve) and a shift in the demand curve, whereby demand is different even if the price remains the same as before. This scenario could occur due to changes in environmental rules inducing more industrial firms to purchase zero-carbon electricity or changes in subsidies and tax credits that makes their product more affordable for firms when compared to fossil fuel services. Suppose a *ceteris paribus* 1% increase in demand would increase firm profits by \$300,000.
- Changes in retained profits. This could occur due to changing revenues, changing costs, but also changing corporate tax rates—including marginal rates and depreciation treatment. Suppose reversing the 2017 tax cuts would, all else equal, increase firm costs by \$5 million.
- Changes in expansion opportunities. This could occur due to changes in permitting standards that may affect the speed at which the firm can develop new geothermal sites or changes in environmental standards may affect which sites can be developed.
- Changes in expansion costs. This may occur due to changes in interest rates may affect the cost of financing new rigs and sites or changes litigation costs from NEPA rules that affect whether local groups can sue to stop a new site development.

The firm will assess what are the factors that will impact each of their potential harms, factors that can impact the likelihood of harms materializing, and factors that can impact the severity of harms should they materialize. Not every harm will be directly impacted by elections and political control, and the contract will not be a part of every hedging strategy. Looking at the transportation cost variable, for instance, the firm may decide that trucking rates are likely unaffected by changes in Congressional control (though in 2022, Congress's vote on the freight rail strike did likely affect trucking prices, a firm may not consider this frequent enough to be worth calculating) and gas prices—while related to political variables—is not easily anticipated by changes in Congressional majorities. Regarding their output price, while wholesale energy prices are certainly influenced by political variables, the firm may determine that the relationship to elections are too attenuated to evaluate. Likewise, while permitting standards under the National Environmental Policy Act is a top priority for the 118th Congress, it's widely viewed as a bipartisan priority and thus unlikely to change regardless of how political conditions evolve.

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But the business may determine that other potential harms will be directly impacted by elections and political control. For example, retained profits and shifts in the demand curve are influenced by which party wins Congress, as parties have substantially different positions on corporate taxes, zero-carbon subsidies, and emission standards for industrial processes.³⁰ As a result, depending on how the Congressional election plays out, certain risks become more salient. Mitigatory actions may be insufficient—the firm cannot cost-efficiently diversify into fossil fuels to reduce their exposure to clean energy subsidy policy in the same way a corn farmer cannot cost-efficiently diversify into an uncorrelated domain in order to reduce their exposure to agriculture prices. A firm may conduct some simple math: a given party winning may increase the probability of beneficial tax changes by 20%, creating an expectation of \$1 million (\$5 million * 20%) more in retained profits, but have a 50% chance of enacting environmental rules that reduce demand by 10%, creating an expectation of loss of \$1.5 million (50% * 10%/1% * \$300,000). As a result, a financial hedging product may be more appropriate. Suppose the probability of Party X winning control of Congress was 33.3% and the price of the \$5000 contract was thus \$1,666.67. In that case, they would purchase 60 contracts for a total of \$100,000. If the adverse event does occur, the firm would be paid \$300,000 to compensate for their expected losses. If the adverse event does not occur, they would not be paid, but they would reap the benefits of the more favorable event occurring.

The chart below summarizes this process. **Green-colored rows** indicate risks that can be mitigated using the CONTROL contract, whereas **magenta-colored rows** indicate risks that would not be hedged by the CONTROL contract.

Potential Harm (Risk)	Factors that could affect the likelihood and severity of the risk	How these risks could be hedged
Transportation cost increases	<ol style="list-style-type: none"> 1. A potential labor strike on the railroads increases trucking rates as rail freight shippers must all now shift to trucking temporarily 2. Russia's war in Ukraine increases the global price of gasoline and diesel fuel 	There is a relationship to Congressional control, but it's likely too attenuated for the Contract to be a useful hedge. Instead, the firm purchases short-contracts on WTI oil and buys long-term trucking contracts

³⁰ This is not just rates. The tax code is filled with numerous and interrelated provisions that impact businesses in different ways. The business may have a number of different provisions that, while seemingly minor to the average citizen, impact them deeply. For instance, while millions of companies are affected by the headline marginal tax rates (making marginal tax rates a good candidate for a policy-specific event contract), a small number are affected by individual provisions such as the treatment of carried interest (for hedge funds) or easements for wetland protection. However, for the firms for which those "minor" provisions matter, they matter a great deal. In order to get enough liquidity, those firms would essentially pool their liquidity on a general Congressional control contract, where the firms who care about each of the thousands of minor provisions all might participate.

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Sales price decreases	<ol style="list-style-type: none"> 1. Large-scale technological advances in hydraulic fracturing technology decreases the price of natural gas, lowering the price by which energy can be sold competitively to industrial users 2. New Congress decreases government zero-carbon energy subsidies previously authorized under the Inflation Reduction Act that were given directly to zero-carbon producers 	Similarly to transportation, the relationship to energy price changes is real but better hedged through oil futures. However, the subsidy risk remains real, and the forms it takes are too manifold to hedge using a specific policy-product, and instead the firm buys Contracts that hedge against a subsidy-hostile Congress winning power
Loss of demand	<ol style="list-style-type: none"> 1. Changes to the overall federal legislative and regulatory approach to energy policy that no longer encourage industrial users to use zero-carbon electricity in the same way 2. Recession results in decreased manufacturing in the business's service area 	Recession risk is best hedged using other instruments—such as shorts on the S&P 500 or a recession-specific event contract. But changes to the overall legislative approach to energy policy is best hedged using a contract that pays out on the basis of Congressional control
Loss of retained profits	<ol style="list-style-type: none"> 1. New Congress reverses the marginal corporate tax rate cuts and bonus depreciation provisions authorized under the Tax Cut and Jobs Act of 2017 2. New Congress introduces new surtaxes and surcharges onto large corporations as part of an effort to reduce the deficit 	TCJA reversal may be able to be hedged using a specific policy-level event contract. However, the second channel is too broad or general for a policy-specific contract, and instead the firm would buy a contract that pays out on the basis of a tax-friendly Congress taking power
Higher input costs	<ol style="list-style-type: none"> 1. New Congress has a more protectionist stance, and has various proposals to—among other things—renegotiate existing trade agreements, reject newly proposed agreements, impose new tariffs on foreign goods, increase regulatory scrutiny on foreign investments, and globally signal a new attitude on trade policy 	The trade uncertainty channel is too broad or general for a policy-specific contract, and instead the firm would buy a contract that pays out on the basis of a more protectionist Congress taking power

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Loss of demand	<ol style="list-style-type: none"> 1. A new Congress has a more restrictive view on antitrust policy and will work to reduce the number and size of mergers and acquisitions through a combination of new legislation, changing personnel in relevant bureaucratic agencies (such as the Federal Trade Commission), and asking those bodies for new regulations 	The decline in M&A activity, as well as general uncertainty in the sector, is too broad or general for a policy-specific contract, and instead the firm would buy a contract that pays out on the basis of a more anti-M&A Congress taking power
Business model regulated or destroyed	<ol style="list-style-type: none"> 1. A new Congress believes that a particular industry or business is socially harmful and decides to ban it, either directly or indirectly through regulation and bureaucratic appointments. Congress has considered doing so with many firms and industries, such as TikTok and e-cigarettes 	A business model being regulated in a punishing way is too broad or general for a policy-specific contract, and instead it would make more sense for the firm to buy a contract that pays out on the basis of a hostile Congress taking power
Loss of expansion opportunities	<ol style="list-style-type: none"> 1. Judicial action strikes down modifications to state-level permitting law reforms, thereby allowing frequent NEPA litigation over site development 2. Interest rates, monetary policy, and tax changes make venture capital markets go tighter, and reducing the access to capital markets 	There are no good hedges to state-level judicial action, and instead the firm should "self-insure" by maintaining a capital buffer. Changes in interest rates and monetary policy can be hedged using other financial instruments, such as interest rate swaps
Increase in expansion costs	<ol style="list-style-type: none"> 1. An unexpected surge in inflation causes the Federal Reserve to hike interest rates, thereby raising the cost of borrowing money to build new rigs 	Increases in inflation and interest rates can be hedged using inflation-protected treasuries or interest rate swaps

Or consider a firm specializing in providing specialized lab-developed tests (LDTs) for certain genomic conditions. They regularly take stock of their company's biggest risk factors. They include:

- Changes in research and development financing costs. Three major factors include changes in funding to the National Science Foundation (NSF) and National Institutes of Health (NIH), changes in interest rates, and research and development tax breaks. They

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estimate that every 1 percentage point increase in interest rates increases their costs by \$5 million.

- Changes in regulatory approval costs. One major contributor to the risk is the probability that Congress changes the law such that LDTs are treated the same as all commercial-use diagnostic tests, thereby changing from the regulatory remit of the Center for Medicare Services (CMS) to the Food and Drug Administration (FDA), where approval timelines are typically substantially longer. They estimate that change would add an additional six months to their approval process, which could cost them roughly \$25 million per year.
- Changes in revenue and profit, which could be affected by changes in Medicare reimbursement rates, which may affect the willingness of hospitals to offer their tests. They estimate that a reduction of 1% in the Medicare reimbursement rate change would cost them \$10 million per year. Another factor related to this risk is changes in corporate taxes, including marginal rates, which may affect overall profitability. They estimate reversing the 2017 corporate tax reductions could cost their company \$3 million.

The firm may determine that NSF/NIH funding remains a bipartisan priority and is unlikely to change regardless of the results of the Congressional elections. Likewise, the effect on interest rates from Congress may be too attenuated to effectively assess; but they determine that legislation to change the regulatory treatment of LDTs is more likely under one political coalition than another. Since they are a firm specializing in LDTs, this risk could be quite severe. As a result, they may wish to purchase a financial product that mitigates their risk exposure.

The relationship between the election and their risks is sufficiently direct that a financial hedge may be valuable. For instance, suppose they believe that Party X winning the midterm election would result in a 16 percentage point increase in the probability that LDT reform legislation becomes law. As a result, the election of Party X creates \$4 million in risk through that channel alone ($0.16 * 25m$). However, Party X winning also reduces the probability of costly corporate tax changes by 33%, thereby reducing the expected loss by \$1 million. As a result, they may wish to purchase \$3 million of hedging products to zero out their extant election risks, which they could do so by purchasing 3,000,000 contracts. They may also wish to only partially hedge by purchasing less than that. Critically, even though the election is not deterministic on their bottom line, it has clear and unambiguous effects on risks to their profitability that can be hedged.

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Hedging example

Kalshi

ECP (cont.)

Risk	Magnitude	Probability if Party X has control
Adverse change in regulatory regime	\$25 million	16% higher
Beneficial tax reduction	\$1 million	33% higher

Hedge: If Party X wins, the increase in risk to the company is \$3 million (-\$4 million from regulatory changes and \$1 million from the tax changes). They may look at the prices of the contract, and may decide to hedge against that risk fully, purchasing contracts that in total payout \$3 million if Party X wins. If Party X loses, they lose the money they spent but they benefit from Party X being out of power.

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E. Similarities to existing products

Many products listed on Commission-regulated exchanges mitigate risk in a similar manner to Kalshi's proposal. For instance, the CME Case-Shiller futures, which pay out based on an index that tracks the overall housing market, does not perfectly map onto any real estate portfolio. It is nonetheless a useful hedging product. Below we have assembled a table that highlights relevant characteristics of existing self-certified products.

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Self-certified contract	Relevant characteristics	Comparison to Political Control Contracts
Micro Bitcoin futures	<ul style="list-style-type: none"> • Geared towards retail participants • The micro size itself does not hedge real economic activity • Does not have price-basing value for other goods and services 	<ul style="list-style-type: none"> • Geared towards retail/firms (original Kalshi submission) or just entities (current submission)³¹ • Allows for hedging real economic activity, even if not 1:1 • Provides valuable price-basing for pricing other assets such as oil, currencies and equities
Cooling and Heating Degrees futures (there are many dozen variations of these, for particular areas and seasons)	<ul style="list-style-type: none"> • Does not perfectly hedge 1:1 anyone's risk, since the primary purchasers (natural gas companies, air conditioner companies) are exposed to energy consumption, but that does not line up either 1:1 with weather or with CDD/HDD 	<ul style="list-style-type: none"> • Similar hedging value proposition: primary purchasers' risk is correlated strongly with elections, even if not perfectly correlated
Case-Shiller Housing Price Index futures (and other real estate futures products)	<ul style="list-style-type: none"> • Does not perfectly hedge 1:1 anyone's risk, since the primary purchasers (real estate investors) have risk that is correlated, but not perfectly correlated, with the overall real estate market and any index in particular 	<ul style="list-style-type: none"> • Similar hedging value proposition: primary purchasers' risk is correlated strongly with elections, even if not perfectly correlated
Hurricane contracts	<ul style="list-style-type: none"> • Does not perfectly hedge 1:1 anyone's risk, since it is uncertain whether a hurricane of a given speed hitting a given area will cause any amount of damage at all, let alone damage to the user, and to what severity 	<ul style="list-style-type: none"> • Similar hedging value proposition: primary purchasers' risk is correlated strongly with elections, even if not perfectly correlated
Equity index	<ul style="list-style-type: none"> • At their inception, equity 	<ul style="list-style-type: none"> • Similar hedging value

³¹ Although the contract will be available to all Exchange members, as required by the CEA and Core Principle 2.

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<p>futures (there are many dozen variations of these live on commodity futures exchanges, e.g. CME's E-mini Utilities Select Sector Futures)</p>	<p>index futures were designed to capture the risks investors faced from the market as a whole. However, the particular indices (such as the S&P 500) do not perfectly capture and hedge 1:1 anyone's risk. Their risk is correlated, but not perfectly correlated, with the overall market. Though some index futures have products that directly reflect them (e.g. S&P 500 ETFs) today this is not true of all index products listed, nor true of any hypothetical product</p>	<p>proposition: primary purchasers' risk is correlated strongly with elections, even if not perfectly correlated</p> <ul style="list-style-type: none"> • Many iterations (e.g. e-Minis, Micros) are targeted and used heavily by retail (original Kalshi submission) or by institutions (current submission)
<p>Consumer Price Index futures</p>	<ul style="list-style-type: none"> • Though individuals and firms are subject to inflation risk, their particular inflation risk is not generally not perfectly correlated with the consumer price index, which chooses a particular set of goods in a particular composition in order to measure inflation 	<ul style="list-style-type: none"> • Similar hedging value proposition: primary purchasers' risk is correlated strongly, though not perfectly with the derivative product in question
<p>CBOE's Volatility Index (VIX)</p>	<ul style="list-style-type: none"> • Though individuals are affected by the risk associated with the stock market, they are not perfectly affected by the risk implied by S&P 500 options 	<ul style="list-style-type: none"> • Similar hedging value proposition: primary purchasers' risk is correlated strongly, though not perfectly with the derivative product in question
<p>Environmental offset futures</p>	<ul style="list-style-type: none"> • In this case, purchasers are not even offsetting personal risk. They are offsetting social risk, risk to society that is caused by their operations; as well as the marginal risk caused to 	<ul style="list-style-type: none"> • Similar hedging value proposition: primary purchasers' risk is correlated, though not perfectly with the derivative product in question

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	them by increased carbon output	
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F. Focus on large-scale hedging

Class	Bona fide hedgers	Everyone else
Individual	\$250K	\$125K
Entity	\$10M	\$5M
ECP	\$100M	\$50M

Position limits for different users of Kalshi's CONTROL contract

Critically, this product is designed for firms, ECPs, and other large-scaled hedgers, although of course individuals are not prohibited from trading, as required by Core Principle 2. The contract order size (multiples of 5,000 contracts) is appropriate for large scale financial hedging activity.

While it is true that not all participants will be hedgers (as with other futures, there need to be some non-hedgers to provide liquidity), with the high contract order size and larger position limits for ECPs and entities, it is highly likely that these non-hedging participants will be sophisticated firms and specialized liquidity providers, which is a dynamic found in many CFTC-regulated markets.

G. Price basing and price discovery utilities

There is extensive price basing utility for the Contract. As discussed earlier, the market frequently reprices assets on the basis of changes in election expectations and election outcomes.³² Investment banks and other research divisions provide clients and the public with recommendations on how Congressional outcomes will change the price of financial assets; an event contract on election outcomes would help price discovery for those products. For example, in 2020, projected a one percentage point lower unemployment rate and a 0.6 percentage point higher S&P 500 under a Democratic sweep.³³

³² There are scores of articles which could serve as examples, but some are: Noel Randewich. 2020. "S&P 500 futures rise as U.S. election suggests less regulatory risk." *Reuters*; Myra P. Saefong. 2020. "Here's how the U.S. presidential election could shake up the oil market." *Marketwatch*; Matthew Weaver. 2020. "Congressional elections could impact commodity prices most, expert says." *Capital Press*.

³³ Moody's Analytics. 2020. "The Macroeconomic Consequences: Trump vs. Biden".

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In 2012, more than two dozen economists signed a letter to the Commission supporting arguing as much. Led by the late Nobel Laureate Kenneth Arrow in that 2012 letter, they wrote:

Political event futures facilitate price discovery in other asset markets. One of the findings of [our] research is that firms and industries are exposed to political and policy risk. Political event futures provide investors with a market-based assessment of outcome probabilities, which reduces investors' uncertainty when trading other assets.³⁴

Many economists have done the same for Kalshi's previous submission, including Nobel Laureate Robert J. Shiller, Phillip Tetlock, Justin Wolfers, Scott Sumner, Michael Abramowicz, Joseph Grundfest, Alex Tabarrok, Michael Gibbs, Jason Furman, David Pennock, Harry Crane, David Rothschild, Koleman Strumpf, Ryan Oprea, and others.³⁵ A letter signed by Pennock, Crane, Rothschild, and Strumpf argued,

Prediction market prices in political and policy events would help facilitate price discovery in a wide-range of asset markets, affecting the entire economy (note that pricing is freely available to non-traders). Political and policy events matter: they expose a wide-variety of businesses to risk that traditional financial markets have trouble pricing. A robust set of markets for political and policy events could price that risk, and, if they were allowed to flourish, could eventually grow to provide hedges where uncertainty is particularly acute.³⁶

The contracts can also be used to price MGEX's corporate tax futures and Kalshi's other political event markets related to bills passing, government shutdowns, and the debt ceiling. They can also be used to price other nonpolitical products, like equities and bonds. For example, imagine a junior investment bank has been instructed to price a security. That price is reflective of the stocks' net present value, itself a reflection of future expected profits. This includes political risk. If that banker knew with certainty that Republicans will take control of Congress, for example, and corporate taxes are thus less likely to be raised, she would price the security higher than otherwise. Kalshi's contracts would help her in doing so.

Many other members of industry and businesses stated as much in public comments, including Angelo Lisboa, Peter Kempthorne, Seth Weinstein, David Pollard, David Trinh, Eriz Zitzewitz, James Cust, Caesar Tabet, Jorge Paulo Lemann, Sebastian Strauss, Christopher Hehmeyer, and Ron Conway.³⁷ Margaret Stumpp, a senior vice president at Prudential Financial and a co-founder of Quantitative Management Associates, wrote,

³⁴ Nadex public comment by Zitzewitz et al. Available at <https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/documents/ifdocs/ericzitzewitzltr020312.pdf>.

³⁵ See public comments 70761, 69708, and 69735.

³⁶ Public Comment by David Rothschild. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69735>.

³⁷ See public comments 69662, 69703, 69718, 70743, 70763, 70747, 70753, 70765, 69684, 69721, 69717, and 69714.

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...a well functioning market for contingent political outcomes should improve the prices at which other securities (eg, stocks, bonds, options, etc...) trade. This reduces uncertainty, enhances capital market liquidity, and improves the efficiency by lowering uncertainty.³⁸

On the standard for price basing

One commenter argued that there is no hedging or price basing use case for the Contract because there is no underlying cash market, unlike with traditional agricultural and energy derivatives.³⁹

This is not the standard that the Commission should apply in its decision. It is not the standard applied in *Nadex* (which considered whether *Nadex*'s proposal could base the price of a physical commodity, financial asset, or service); it is also not the standard that the Commission asked the public to use in judging *Kalshi*'s original submission (which uses the same test as *Nadex*). To do otherwise and limit price basing to only contracts with an underlying cash market would be arbitrary.

It would also essentially invalidate the existence of price basing, or price discovery, for the vast majority of event contracts, which do not have underlying cash markets. This is inconsistent with Commission precedent and would upend myriad products listed with the Commission in the last two decades. Many derivatives products currently listed with Commission-registered Designated Contract Markets do not have underlying cash markets, such as:

- Macroeconomic indicator derivatives (e.g. Gross Domestic Product contracts)
- Tax rate derivatives (e.g. MGEX's corporate tax rate futures)
- Weather derivatives (e.g. hurricane and heating/cooling degree days contracts)
- Carbon offset futures (e.g. CME's CBL Global Emissions Offset Futures)
- Housing price index futures (e.g. CME's futures based on Case-Shiller house price indices)

Because of the permissionless nature of self-certification, the Commission has not *specifically* stated that the above contracts have hedging or price basing utilities; the Commission did so implicitly by permitting their registration for decades. However, in some cases, the Commission has been specific. For example, the Commission actively determined that futures which pay off based on the amount of box office revenue a motion picture produces has price basing utility, even though it has no cash commodity market.⁴⁰

³⁸ Public Comment by Margaret Stumpp. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69722>.

³⁹ Public Comment by Steve Suppan. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70791>.

⁴⁰ "The Commission found that the contracts can perform hedging and price discovery purposes... The Commission analysis applied three tests to determine whether or not these contracts could be used by an identifiable segment of an industry or industries for hedging or price basing on more than an occasional basis."

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The price basing value of Kalshi's proposal is no different. A market-based determination of the probability of a given party taking control of a given chamber of Congress would be helpful in basing the price of politically sensitive commodities (such as oil), assets (such as politically sensitive stocks, like cannabis and energy firms), and services (such as investments in politically sensitive sectors).

There is no hard and fast rule defining when price basing does and doesn't occur in a manner sufficient to justify a CFTC-listed derivative. In some cases, the Commission/Commission staff indicated that price basing is when a commodity future specifically bases the price of its underlying commodity; in other cases, also related commodities;⁴¹ in other cases (including Kalshi's), also non-commodities.⁴²

Several Commissioners have indicated in statements they believe that intangible event contracts, sans cash markets, have price basing utility. This includes Commissioners Brian Quintenz and Dan Berkovitz in the case of ErisX's proposed NFL Futures Contracts; Commissioner Sharon Brown-Hruska when discussing how event contracts may have primarily price discovery as opposed to hedging functions; as well as Commissioners Quintenz and Mark Wetjen on election contracts themselves.⁴³⁴⁴⁴⁵⁴⁶ In fact, in its release discussing event contracts in 2008, Commission

<https://www.cftc.gov/sites/default/files/idc/groups/public/@otherif/documents/ifdocs/mdexcommissionstatement061410.pdf>.

⁴¹ For example, the CFTC's rule on Exempt Commercial Markets describes price basing this way at some points, as does the definition provided on the Commission's website; at other points, the rule refers to price basing as being about only the underlying commodity itself.

⁴² For example, the Commission's decision in *Nadex* or the Commission's questions for the public in Kalshi's original submission specifically discuss whether the contracts can be used for basing the price of a physical commodity, financial asset, or service. The Commodity Exchange Act also does not specify what derivatives must or should be managing price risk/discovering prices/price basing for.

⁴³ Statement of Commissioner Dan M. Berkovitz Related to Review of ErisX Certification of NFL Futures Contracts, April 7, 2021, available at

https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement040721#_ftn27 *Note:* Commissioner Berkovitz argues that, although he does not believe ErisX demonstrated price basing utility, he does clarify that it could have such utility, and is open to being shown that.

⁴⁴ The Functions of Derivative Markets and the Role of the Market Regulator, May 18, 2006. Dr. Sharon Brown-Hruska, Commissioner, available at

<https://www.cftc.gov/PressRoom/SpeechesTestimony/opabrownhruska-45>

⁴⁵ See Public Comment on Kalshi Contract from Brian D. Quintenz, available at:

<https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70786>

⁴⁶ See Public Comment on Kalshi Contract from Mark Wetjen, available at:

<https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70771>

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staff used election markets to describe how price discovery in event contracts could work.⁴⁷ This utility was true then, and it remains true today.⁴⁸

The law, similarly, does not restrict price basing to specifically the commodity upon which the derivative is based. Specifically, the CEA says, “transactions subject to this Act are entered into regularly in interstate and international commerce and are affected with a national public interest by providing a means for managing and assuming price risks, discovery prices, or disseminating pricing information through trading in liquid, fair and financially secure trading facilities.”

Even if the Commission had used the standard whereby price basing only applies to an underlying cash market (and it has not) at one point, why should it continue to do so in the future? The fact that a derivative can provide price discovery for a different commodity, asset, or service is consistent with the CEA’s price discovery goals; stopping a derivative from being listed on that basis is inconsistent with it. Moreover, the fact that a derivative could be used for price discovery for another kind of product or service suggests relation, falling within one of the common definitions Commission staff use in describing price basing.

That being said, if the standard was “related” commodity, election markets are patently related to major commodity markets, such as energy and agricultural markets. The United States government is a major participant in such markets, both directly trading in them and providing significant industry subsidies. In addition, research has consistently found a link between elections and changes in oil prices, demonstrating that the market is using election probabilities to base the price of commodities and commodity futures.⁴⁹

H. Other comments on hedging and pricing issues

A few commenters disputed the hedging and/or price basing utilities of the contract in ways that are not addressed by the above. They said:

⁴⁷ As noted above, the Commission’s release stated that “The trading of such contracts can facilitate the discovery of information by assigning probabilities, through market-derived prices, to discrete eventualities. For example, a binary contract based on whether a particular person will run for the presidency in 2012, can pay a fixed \$100 to its buyer if and only if that individual runs for the presidency in 2012. If the contract’s traders believe that the likelihood of the individual’s candidacy in 2012 is around 17 percent, the price of the contract will be around \$17, and will approximate the market’s consensus expectation of the individual’s candidacy.”

<https://www.federalregister.gov/documents/2008/05/07/E8-9981/concept-release-on-the-appropriate-regulatory-treatment-of-event-contracts>

⁴⁸ The fact that the concept release predated Dodd-Frank is of no consequence. The point is that the contract has obvious price basing utility, and even if Dodd-Frank, *arguendo*, reincarnated the economic utility test, the contract passes because of its price basing utility.

⁴⁹ *E.g.* Erik Snowberg, Justin Wolfers and Eric Zitzewitz. “Partisan Impact on the Economy”. *Journal of Economic Perspectives*. 2004.

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- The \$25,000 position limit was not enough to constitute hedging for most businesses and institutions. In Kalshi's new submission, the position limits have been raised, with an emphasis on those with established hedging needs.
- Election outcomes are not sufficiently predictable in order to justify a hedging product. Above, evidence is provided that market participants extensively discuss, hedge, and price election risk well before a new Congress is even seated. If the market is already doing so, then there is no place to say otherwise.
- Election risk can be de-risked through other equities and derivatives products. However, other products are insufficient to hedge electoral risk, which is a unique risk that could flow through many different parts of a firm's business. Moreover, there is no "uniqueness" requirement that hedging products have.
- One commenter, Richard Q. Wendt, argued that hedging behavior would reduce the Contract's informational utility, since hedgers are less price sensitive than speculators. However, large, liquid markets with hedgers, speculators, and liquidity dealers are broadly able to simultaneously provide accurate pricing information and hedging opportunities. For example, when the price of an oil future is pushed down below fair market value by a price insensitive hedger, speculators come in and push the price back up to take advantage of the discrepancy between the current price and the fair price.
- The Commission, in its questions, questioned whether it should be considering what percentage of a given market must be made of hedgers versus speculators; as well as whether hedging needs can be merely theoretical or need "evidence". These standards were not applied against Nadex, ErisX, or any other contract proposed to the Commission. They are not found in law, rule, or regulation; although Kalshi's contract clearly does have established hedging utility, it would be arbitrary for the Commission to impose novel burdens on it.

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**APPENDIX D (CONFIDENTIAL) – COMMISSION JURISDICTION AND THE
SPECIAL RULE FOR EVENT CONTRACTS**

In addition to the details discussed below, Kalshi has attached letters on the matter from former Commission General Counsel Daniel Davis and Jonathan Marcus, as well Commissioner Caroline Pham’s dissent on whether to impose a stay and review pursuant to Regulation 40.11 of Kalshi’s original submission. Additional commenters on this point include, but are not limited to, former Nadex CEO Timothy McDermott, former Commissioner Brian Quintenz, former Commissioner Mark Wetjen, “father of futures” Dr. Richard Sandor, Gregory Kuserk, who led the Product Review branch in DMO, former MPD Director Josh Sterling, Daniel Gorfine, Lewis Cohen, Jeremy Weinstein, Susquehanna International Group, Tabet DiVito & Rothstein, and Railbird Technologies.⁵⁰ Kalshi has adopted these comments and they form part of the basis on which Kalshi determined that this contract is consistent with the CEA. Rather than attach all the comments here, which would consume a fair bit of paper, Kalshi has referenced them in the prior footnotes and notes that these comments are all in the Commission’s possession and available on the Commission’s website. However, should the Commission find it convenient to have all of these comments attached, Kalshi will supply them to the Commission.

Commission jurisdiction

Section 2(c)(2)(A)(ii) of the Act provides that the Commission has jurisdiction over swaps. Swaps are defined in section 1a(47)(ii) of the Act to include, among other things, “any agreement, contract, or transaction . . . that provides for any purchase, sale, payment, or delivery (other than a dividend on an equity security) that is dependent on the occurrence, nonoccurrence, or the extent of the occurrence of an event or contingency associated with a potential financial, economic, or commercial consequence.” The Contract provides for payments that are dependent on the occurrence, nonoccurrence, or the extent of an event. The Contract is therefore a swap, and the listing and trading of the contract on Kalshi are therefore under the Commission’s jurisdiction. Section 5c(c)(5)(B) and Commission Regulation 40.2(b) create a presumption in favor of approving contracts.

Special rule for the review and approval of event contracts

Section 5c(c)(5)(C) of the Act provides a special rule for the review and approval of event contracts. Under this special rule, the “Commission *may* determine” (emphasis added) that event contracts or swaps (“based upon the occurrence, extent of an occurrence, or contingency”) are “contrary to the public interest” if those contracts “involve” certain enumerated activities.⁵¹ 7

⁵⁰ Public comments 70786, 70771, 69687, 70754, 69737, 70755, 69736, 69723, 70743, 70765, 70752.

⁵¹ The relevant language of “involve, relate to, or reference” comes from Commission regulation 40.11. This language cannot be broader than the statutory language that is simply “involves”. By definition, if the regulation applied more broadly than the statute, it would *per se* violate the APA and be invalid.

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U.S.C § 7a-2(c)(5)(C)(i).⁵² Those enumerated activities are: an “(I) activity that is unlawful under any Federal or State law; (II) terrorism; (III) assassination; (IV) war; (V) gaming; or (VI) other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.” *Id.* The discretionary use of this special rule for event contracts is implemented in the Commission’s Regulations. 17 C.F.R. § 40.11, which provides that “the Commission *may determine*” that a certain contract “may involve” one of the enumerated activities and subject that contract to a 90-day review period after which it “shall issue an order” with its determination.⁵³ 17 C.F.R. § 40.11(c).

The CEA’s special rule for event contracts applies to contracts that “involve” one of the six enumerated activities: an “(I) activity that is unlawful under any Federal or State law; (II) terrorism; (III) assassination; (IV) war; (V) gaming; or (VI) other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.” 7 U.S.C § 7a-2(c)(5)(C)(i)(I)-(VI). These specific examples demonstrate that the term “involves” in the statute (and application of the special rule) refers to the actual “occurrence, extent of occurrence, or contingency” that forms the underlying basis for the contract to be traded; and not the trading of the contract itself.

The statute’s second enumerated activity is “terrorism,” and thus, a contract that “involves” terrorism is subject to the CEA’s special rule for event contracts. An event contract will involve terrorism if the underlying event that forms the basis of the contract is terrorism; the act of trading on a contract itself is not terrorism. The same is true for the third and fourth enumerated activities. An event contract will “involve” assassination when the underlying event that forms the basis of the contract is assassination; the act of trading itself is obviously not assassination. An event contract will “involve” war when the underlying event that forms the basis of the contract is war; the act of trading itself is obviously not war. This common sense understanding is explicit in the statute. The statute’s first and the sixth enumerated activities are an “*activity* that is unlawful under any Federal or State law” and “other similar *activity* determined by the Commission, by rule or regulation, to be contrary to the public interest.” (emphasis added) The noun “activity” makes it clear that the statute is referring to the underlying event, not to the *activity* of trading on the contract.⁵⁴ Thus, the statute is clear that an event contract “involves” an

⁵² If the Commission chooses to review an event contract to determine whether it is contrary to the public interest and finds that a listed event contract is “contrary to the public interest,” that contract may not be “listed or made available for clearing or trading on or through a registered entity.” 7 U.S.C § 7a-2(c)(5)(C)(ii).

⁵³ As interpreted by former Commissioner Dan Berkovitz, regulation 40.11 mirrors the statute, 7a-2(c)(5)(C), and sets forth the process for the Commission to determine whether a specific event contract is contrary to the public interest. Statement of Commissioner Dan M. Berkovitz Related to Review of ErisX Certification of NFL Futures Contracts, April 7, 2021, available at https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement040721#_ftn27 (“Berkovitz Statement”).

⁵⁴ Although this is abundantly clear with regard to five of the six enumerated events, an argument might be mounted that it is not true with regard to the fifth of the enumerated activities, gaming. This argument fails, as it is a basic tenet of both semantic and substantive statutory interpretation that a single usage of a word, in this case “involve”,

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enumerated activity when the underlying event that forms the basis of the contract, not the trading on the contract, involves the activity.

The statute's first enumerated activity ("activities that are illegal under federal or state law") further buttresses the conclusion that it is the underlying event that forms the basis of the contract that is relevant to the special rule and not the act of trading itself. If "involves" means that the trading on the contract is the enumerated event, that would mean that CEA's special rule applies to trading on a contract *when the trading on the contract itself already violates federal law*. Recall that the special rule does not prohibit such contracts, it merely authorizes the Commission to make that determination. It would be odd for Congress to make a federal law that makes trading on a certain contract illegal, but nonetheless say listing that contract is prohibited only if the CFTC determines that it is against the public interest. Once Congress made it illegal, it is unlikely it would have turned around and allowed it unless the CFTC agrees that the activity is disfavored.

Instead, it is abundantly clear that the enumerated activity of "illegal under federal law" means that the underlying event that forms the basis of the contract is illegal under federal law, not that the trading on that contract is illegal under federal law. An example of a contract that would fall under this first enumerated activity is a contract on the number of people that commit tax evasion. Tax evasion is a felony under I.R.C. § 7201. Trading on the contract is obviously not tax evasion. Nonetheless, that does not matter. The event in that contract is an activity that is illegal under federal law. The fact that trading on the contract is not illegal under federal law is irrelevant, because whether the CEA's special rule for event contracts applies to an event contract is determined based on whether the underlying event that forms the basis of the contract is an enumerated activity, not the act of trading on the contract.⁵⁵

Because it is the underlying event that forms the basis of the contract that is the only trigger of the CEA's special rule for event contract review, political control event contracts are clearly not included in that rule. The event that underlies these contracts is the political control of the United States Congress by a political party. Political control of government by a political party is obviously not illegal under federal or state law. It is not an activity that the Commission has determined to be contrary to the public interest. Nor is it terrorism, assassination, war, or a game. As such, political control contracts are not included in the narrow reach of the CEA's special rule

will not have two meanings, one for items 1, 2, 3, 4, and 6 on a list, and a second meaning for item 5 on that same list.

⁵⁵ The rare exception to this would be when the act of trading a contract itself is prohibited, as is the case for contracts "for the sale of motion picture box office receipts (or any index, measure, value, or data related to such receipts) or onions for future delivery" which are expressly prohibited in the Act. 7 U.S.C § 13-1. Trading a political control contract, however, is not prohibited by the Act nor is the underlying event illegal.

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for certain, enumerated activities and the rule and relevant regulations (17 C.F.R. § 40.11) does not apply.⁵⁶

Additionally, the activities that are enumerated can be seen as all involving an undesirable activity. Terrorism, war, assassination, illegal activity, and gaming are activities that can be considered “undesirable”. The sixth activity too is essentially any other activity that the Commission considers to be undesirable. Political control is not one of those activities.

However, even if one did believe that the Commission should consider whether trading on the contract itself is part of “involve”, the Contracts would still not involve either gaming or illegal activity.

A. Gaming

Elections and political control are not games

Unlike games, in which the underlying activity has no inherent economic value apart from the money wagered on it, political control has an obvious and large economic impact, as it heavily influences expectations and the likelihood of public policy change. As Gregory Kuserk noted, unlike games, “Elections are events that are very important to the public, and there is a very strong public interest in having accurate data regarding elections.”⁵⁷ Kalshi detailed as much in dozens of pages of evidence provided to the Commission, drawing on private and university research, policymaker and industry testimony, and the financial press.⁵⁸ Many public comments by retail, industry, and academia have confirmed as much.⁵⁹

Kalshi’s contracts do not involve gaming. It involves the partisan affiliation of the Speaker of the U.S. House of Representatives and the U.S. Senate’s President *pro tempore*, which are not

⁵⁶ The Commission in the Nadex order took a very expansive view of the authority that the CEA conferred on it with the special rule for event contracts. The Nadex Order stated simply “the legislative history of CEA Section 5c(c)(5)(C) indicates that the relevant question for the Commission in determining whether a contract involves one of the activities enumerated in CEA Section 5c(c)(5)(C)(i) is whether the contract, considered as a whole, involves one of those activities.” However, the legislative history that the Commission pointed to back then is of the weakest kind, a simple colloquy between two senators about preventing contracts on game outcomes, and certainly not enough to override the clear semantic and substantive indications in the statute itself as to what it means. The Commission should not reinforce a flawed legal position from a decade ago.

⁵⁷ Public Comment by Gregory Kuserk. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70754>.

⁵⁸ Memorandum in Support of Kalshi’s Political Control Contracts, submitted to Division of Market Oversight (DMO) March 28, 2022.

⁵⁹ See, for example, public comments by Chicago Booth school Professor Michael Gibbs and Susquehanna International Group Special Counsel David Pollard. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69704> and <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70743>.

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determined through or relate to games of chance, or games of skill.⁶⁰ Elections are not games, full stop. Indeed, the *Nadex Order* did not identify political elections themselves—the core of American democracy—as being a game.⁶¹

Trading on Congressional control is not gaming

The *Nadex Order* asserted that gaming is equivalent to placing a wager or bet, and it cited a federal statute that defined the term bet or wager as “the staking or risking by any person of something of value upon the outcome of a contest of others.”⁶² It further concluded that this is the same as taking a position on a Congressional control contract. If taking a position on a Congressional control contract is equivalent to a ‘wager’ or ‘bet’ because it places money on an event’s outcome, that would imply that taking a position in any event contract is also equivalent to a ‘wager’ or ‘bet’.⁶³ This would imply that event contracts themselves violate state gambling laws. This is incorrect. While gambling is illegal in many states and interstate betting is prohibited, event contracts are legal in all jurisdictions. Political control is also not a “contest” even if it indirectly involves competition. Trading on an event contract is also not the same as a “bet” in practice; as former Commissioner Quintenz wrote:

Gaming describes wagering money on an occurrence that has no inherent economic value itself other than the money wagered on its outcome. For instance, wagering money on roulette or blackjack should be considered gaming because there is no economic significance of the activity apart from the wager itself. Speculation, on the contrary, is risking value where the underlying activity has economic consequences, which then means the speculative activity creates valuable societal and economic benefit from a price-discovery and risk transfer function for those exposed to the risk of that underlying activity.⁶⁴

B. Illegal activity under federal or state law

Kalshi’s Contract does not involve illegal activity. Taking a position in an event contract is not equivalent to, as states or the federal government may define it, “gaming” “gambling” or “wagering”. This is not true legally (interstate betting is illegal, and betting is illegal in many states; event contracts are legal in all jurisdictions) or in practice. As then Commissioner Quintenz wrote in his *ErisX* statement,

⁶⁰ Kalshi’s Congressional control submission, available at:

<https://www.cftc.gov/sites/default/files/filings/ptc/22/08/ptc082422kexdcm001.pdf>. See page 9.

⁶¹ In the Matter of the Self-Certification by North American Derivatives Exchange, Inc. of Political Event Derivatives Contracts and Related Rule Amendments under Part 40 of the Regulations of the Commodity Futures Trading Commission (April 2, 2012), available at:

<https://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/nadexorder040212.pdf>.

⁶² *Nadex Order* at 3

⁶³ Some commentators appear to equate speculation with gaming and do not sympathize with the important role speculation plays in price discovery and risk transfer. Many commodity futures markets, such as those in oil, often feature large amounts of speculative behavior yet clearly do not constitute “gaming” contracts.

⁶⁴ See Public Comment on Kalshi Contracts from Brian D. Quintenz, available at:

<https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70786>

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Whereas bettors participate in games of pure chance, whose sole purpose is to completely reward the winner and punish the loser for an outcome that would otherwise provide no economic utility (think roulette), speculators in the derivatives market participate in non-chance driven outcomes that have price forming impacts upon which legitimate businesses can hedge their activities and cash flows.⁶⁵

Taking a position in an event contract is also not equivalent to gaming, as defined by those laws, because such laws are not operative on CFTC-regulated products. Federal law definitions of gaming, betting, and wagering (such as the Wire or Unlawful Internet Gambling Enforcement Act) carve out exemptions for CFTC-regulated products.⁶⁶ This includes the definition of gaming cited by the *Nadex Order*. Many states' gaming provisions also include such exemptions.⁶⁷ States' gaming provisions are preempted explicitly as well by the Commodity Futures Modernization Act ("CFMA").⁶⁸ Congress has repeatedly recognized that futures and other derivative contracts serve economic purposes and, therefore, state laws that purport to prohibit or regulate futures or derivative contracts (including gaming laws) do not violate the CEA and are preempted. There is a critical distinction between betting and legitimate, federally recognized and regulated financial activity. Election contracts that are designed for price formation and hedging on a derivative exchange constitute legitimate financial activity. Therefore, it would be incorrect to give consideration of the definitions under state and federal gambling laws. As these laws themselves recognize, they do not apply to contracts like Kalshi's.

Indeed, a key purpose of the CEA and granting the CFTC exclusive jurisdiction over futures was to authorize and promote trading of futures contracts notwithstanding state laws that might purport to prohibit them as gambling. The only way in which state law is relevant is if the activity underlying the event contract violates state law, such as a contract on murder or state income tax evasion. In that case, Congress wanted to make sure that a futures contract would not legitimize that activity without the Commission considering whether trading the contract would be contrary to the public interest.⁶⁹

⁶⁵ See Statement of Commissioner Brian D. Quintenz on ErisX RSBIX NFL Contracts and Certain Event Contracts, "Any Given Sunday in the Futures Market" (Mar. 25, 2021), available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/quintenzstatement032521>

⁶⁶ The Unlawful Internet Gambling Enforcement Act of 2006 "do[es] not include...any transaction conducted on or subject to the rules of a registered entity or exempt board of trade under the Commodity Exchange Act". 31 U.S.C. § 5362(1)(E) (2006).

⁶⁷ For example, Washington state RCW 21.30.030 clarifies that CFTC-regulated transactions are not affected by its anti-bucket shop provisions.

⁶⁸ 7 USC 2(a)(1) covers exclusive CFTC jurisdiction over futures and swaps, so any state laws that would purport to regulate or prohibit futures or swaps would be preempted. The CEA also preempts state gaming laws with respect to derivative products that are excluded or exempt from the CEA. See 7 USC 16(e)(2) ("This Act shall supersede and preempt the application of any State or local law that prohibits or regulates gaming or the operation of bucket shops . . . in the case of --- (A) an electronic trading facility excluded under section 2(e) of this Act; and (B) an agreement, contract, or transaction that is excluded from this Act under [provisions of] the Commodity Futures Modernization Act of 2000, or exempted under section 4(c) of this Act.").

⁶⁹ Congress obviously would not be concerned about legitimizing elections. Even if the focus comes to legitimizing the trading on elections as part of the ultimate public interest analysis, the Commission has already crossed that

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Additionally, many broad state gambling laws would define *all* event contracts as gaming, as well as many other futures, swaps, and options. States like New Hampshire, for example, define gambling as having “to risk something of value upon a future contingent event not under one’s control or influence.”⁷⁰ If the Commission were to find that the contracts involve gaming on the theory that New Hampshire state law prohibit gambling/wagering on elections, that would mean “wagering” is equivalent to taking a position on any event contract, which in turn would require that the Special Rule is triggered by *any* event contract because many New Hampshire’s and many other state’s gambling laws prohibit wagering on the outcome of *any* future event. That interpretation was clearly not Congress’ intent. Instead, Congress narrowly defined a small number of event contracts whose underlying event involves an unsavory activity that Congress did not want the CFTC to legitimize without evaluating whether trading a contract on that activity would be contrary to the public interest (as per the text, which isolates a selected set of enumerated events to target).

Time and time again, Congress and states have indicated that the Commission has the decision making power over derivatives market issues, including event contracts, and approval of Kalshi’s contract has no involvement with gaming any more than an event contract on the growth of Gross Domestic Product or whether a bill becomes law. If the Commission chooses to isolate these contracts as involving gaming but not those many others, it would be acting contrary to Commission precedent and in an arbitrary manner.

bridge by long permitting market participants to trade such contracts pursuant to no action letters awarded to unregulated markets, such to Iowa Electronic Markets and PredictIt. The notion that allowing a regulated exchange to offer the contracts is what changes the public interest analysis is insupportable.

⁷⁰ New Hampshire Rev Stat § 647:2(II)(d) (2017); see also Alaska Stat. § 11.66.280(3) (“gambling” means that a person stakes or risks something of value upon the outcome of a contest of chance or a future contingent event not under the person’s control or influence, upon an agreement or understanding that that person or someone else will receive something of value in the event of a certain outcome”); Oregon Rev. Stat. § 167.117(7) (“‘Gambling’ means that a person stakes or risks something of value upon the outcome of a contests of chance or a future contingent event not under the control or influence of the person . . .”).

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APPENDIX E - OTHER CONSIDERATIONS FOR THE PUBLIC INTEREST

This section will be split into two sections: first, why the Contract is affirmatively in the public interest; and second, addressing objections thereof from the comment file.

A: Kalshi's Contract will provide significant social value

The contracts have a strong economic purpose.

The hedging and price basing use cases are myriad and would allow individuals to take advantage of a product that is currently strongly in demand. Elections cause extremely large economic impacts and are some of the biggest risks that many businesses will encounter. This is detailed at great length in Appendix B and has been validated by dozens of public comments from retail, business, academia, and members of industry.

The contracts would serve as useful tools for voters, the media, and the public that would fight disinformation, improve election integrity, and improve decision making including policy making

The demand for accurate information surrounding elections is enormous—and valuable. This is why so many Americans turn to election models and updates offered by *FiveThirtyEight*, *The New York Times*, and *The Economist* around election time for advanced election models. Unregulated exchanges created by the Commission, such as PredictIt, are also very popular for this purpose. Its markets are consistently referenced as informative and useful by major, credible news organizations like *CNN*, *CNBC*, *Politico*, *Bloomberg*, *The Economist*, *The Wall Street Journal*, *The Washington Post*, and *The New York Times*, across sections like *The Upshot*, *DealBook*, opinion columns, and the technology section. In addition, PredictIt has repeatedly been cited by prominent political officials and thinkers. Examples include economists like Jason Furman, previously President Obama's Council of Economic Advisors Chair; Nobel Laureate Paul Krugman, a Professor at The Graduate Center and a columnist for *The New York Times*; and data scientists/reporters like Nate Silver, founder and editor-in-chief of *FiveThirtyEight*.⁷¹⁷²

In a public comment, Furman also emphasized the importance of election markets for policy making. As he wrote,

⁷¹ Examples of this include: La Monica, Paul R. "Joe Biden's Fed conundrum: Stick with Jerome Powell or let him go?" *CNN*. 2021; Heath, Thomas. "These gamblers are putting money on the outcome of the impeachment inquiry." *Washington Post*. 2019; Contrera, Jessica. "Here's how to legally gamble on the 2016 race." *Washington Post*. 2016; *The New York Times* search results: <https://www.nytimes.com/search?query=PredictIt>; <https://twitter.com/NateSilver538/status/1242845027014971394>; <https://twitter.com/jasonfurman/status/1460404350975680514>; and <https://twitter.com/paulkrugman/status/1177602108763316227?lang=en>.

⁷² Public comment letter by Jason Furman. Available at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69708>.

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...in the White House I, along with other members of the economic team, would regularly refer to prediction markets on electoral outcomes and specific events to help inform our understanding of how political and economic developments would affect economic policymaking. In understanding the risks of a government shutdown or debt limit showdown, for example, it would be helpful to understand what informed traders with money at stake would expect—a method of understanding probabilities that research has consistently shown is superior to other ways of summarizing and updating based on information.⁷³

Professor Furman went on to detail the other benefits for the contract, including helping academic researchers and educational benefits, a point also made by others, including Sebastian Strauss. PredictIt also has been used to promote civic engagement by undergraduates. Berg and Chambers (2016) found that using prediction markets, including PredictIt, increased user interest in civics and user news consumption.⁷⁴

The preponderance of the academic literature suggests that existing media has misaligned incentives when it comes to reporting on a given party's chances of political control. This often results in bad reporting. For example, University of Pennsylvania professor Philip Tetlock evaluated the statements made by pundits and found that 15 percent of predictions claimed to be "impossible" did indeed occur and 27 percent of predictions claimed to be a "sure thing" did not.⁷⁵

By providing an instant check against pundits, a market-based price created by the contracts can aid information aggregation for the public. For the numerically-inclined or the financially-minded, a viewer can see that one commentator is asserting that party X is a "sure thing" but the Kalshi contract gives them only (e.g.) a 20% chance of winning. They now have a competing alternative to that pundit's information.

Markets tend to be more accurate than any pundit or forecasting alternatives. The efficient, price-discovering nature of markets in a wide range of contexts is a well-substantiated finding in academic research.⁷⁶⁷⁷⁷⁸⁷⁹ The collective wisdom of many people who have a direct monetary stake in the outcome results in a valuable price signal. Weather derivatives and agricultural

⁷³ *Ibid*

⁷⁴ Berg & Chambers. *Bet Out the Vote: Prediction Markets as a Tool to Promote Undergraduate Political Engagement*. 2018. *Journal of Political Science Education*.

⁷⁵ Philip Tetlock. "Expert Political Judgment". 2005.

⁷⁶ Justin Wolfers and Eric Zitzewitz. 2004. "Prediction Markets." *Journal of Economic Perspectives*.

⁷⁷ Kenneth J. Arrow, Robert Forsythe, Michael Gorham, Robert Hahn, Robin Hanson, John O. Ledyard, Saul Levmore, Robert Litan, Paul Milgrom, Forrest D. Nelson, George R. Neumann, Marco Ottaviani, I Thomas C. Schelling, I Robert J. Shiller, Vernon L. Smith, Erik Snowberg, Cass R. Sunstein, Paul C. Tetlock, Philip E. Tetlock, Hal R. Varian, Justin Wolfers, and Eric Zitzewitz. 2008. "The Promise of Prediction Markets." *Science Magazine*.

⁷⁸ Joyce Berg, Forrest D. Nelson, and Thomas A. Reitz. 2008. "Chapter 80 Results from a Dozen Years of Election Futures Markets Research." *Handbook of Experimental Economics Results*.

⁷⁹ Georgios Tziralis and Ilias P. Tatsiopoulos. 2007. "Prediction Markets: An Extended Literature Review." *The Journal of Prediction Markets*.

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futures are better at predicting the weather than meteorologists.⁸⁰ Markets trading on the reproducibility of scientific research are better at discovering which papers will reproduce than experts, who do no better than chance.⁸² Most importantly, research studying IEM and PredictIt have confirmed that markets provide more accurate information than traditional forecasting methods.⁸³⁸⁴

Kalshi's contracts would provide a visible, well-trusted benchmark against which to evaluate a pundit's predictive power. As Professor Tetlock observed, "prudent consumers should become suspicious" when they confront a public record of poor performance relative to the market. In his words, "Unadjusted ex ante forecasting performance tells consumers in the media, business, and government what most want to know: how good are these guys in telling us what will happen next?"⁸⁵

The contracts would not serve as threats to either election integrity or the perception thereof; instead, it would improve them both (also discussed at length in Appendix G, as part of Core Principle 3 analysis)

It is important for the Commission to engage with the evidence on election integrity rather than speculate. The *Nadex Order*'s suggestion that voters could be incentivized to switch their votes, and thus harm election integrity, was outright speculative in 2012, and has since been disproven by the success of a Commission-sanctioned but unregulated market, PredictIt. PredictIt has grown to more than a billion shares traded—with little hedging participants because of the Contract's low position limits—without any claim of, let alone proof of, election impropriety driven by those markets.⁸⁶ Election trading is also common over-the-counter among the largest financial institutions and high net worth individuals.⁸⁷ Today, election trading remains alive and well in other democracies like the United Kingdom, Australia, Ireland, and New Zealand, without documented attempts at—let alone successful—distortion of the electoral process. Several commenters confirmed this, including Eric Crampton, the academic advisor to iPredict, a New Zealand based political prediction market:

⁸⁰ Richard Roll. 1984. "Orange Juice and Weather." *The American Economic Review*.

⁸¹ Matthias Ritter. 2012. "Can the market forecast the weather better than meteorologists?" *Economic Risk*.

⁸² Anne Dreber, Thomas Pfeiffer, Johan Almenberg, Siri Isaksson, Brad Wilson, Yiling Chen, Brain A. Nosek, and Magnus Johannesson. 2015. "Using prediction markets to estimate the reproducibility of scientific research." *PNAS*.

⁸³ Joyce Berg, Forrest D. Nelson, and Thomas A. Reitz. 2008. "Chapter 80 Results from a Dozen Years of Election Futures Markets Research." *Handbook of Experimental Economics Results*.

⁸⁴ Joyce Berg, Forrest D. Nelson, and Thomas A. Reitz. 2006. "Prediction market accuracy in the long run." *International Journal of Forecasting*.

⁸⁵ *Ibid*

⁸⁶ PredictIt.

<https://www.predictit.org/insight/aHR0cHM6Ly9hbmFseXNpcy5wcmVkaWN0aXQub3JnL3Bvc3QvMTg4NzQ3ODgwMDQzL2EtcHJIZGljdGFibGUtbnV3c2xldHRlci0xMTEwOSNtb2JpbGU=>

⁸⁷ Public Comment by Angelo Lisboa. Available at:

<https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69662>

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What experience we had with iPredict suggests CFTC really doesn't have anything substantial to worry about in allowing contracts on political events. If anything, they heightened voter engagement. The CE [Chief Executive] of iPredict even featured on the nightly news during the election, giving the latest on election market prices. And for that brief period, whenever blowhard partisans insisted that some outcome was going to happen, people could just point to the iPredict price on the event and ask them why they thought that price was wrong, and whether they'd actually put their money where their mouth was. It was a remarkable era. iPredict inflation forecasts (they also had markets on inflation going out several years - it was so very good) wound up being noted in our Reserve Bank's Monetary Policy Statements. I desperately miss it. I envy the opportunities Americans could have if CFTC takes a sensible approach to regulation.⁸⁸

Or Dustin Moskowitz, a co-founder of Facebook and founder of Asana:

Of course, it's important to validate that these contracts would not conflict with the public interest, and specifically the integrity of our elections. I am confident, however, they would not do so. Similar markets not only exist in many liberal democracies like the UK, but create a thriving scene that actually encourages voter participation and engagement.⁸⁹

The economic impacts of elections themselves dwarf the value of Kalshi's contracts many, many times over. Likely trillions in stock value are deeply dependent on elections; entire sectors, firms, and places can be favored by a candidate for office; and almost every actor in the economy is directly affected by tax rates. The marginal addition of Kalshi's contract will not change whether or not elections are events of enormous consequence, and thus not increase anyone's incentive meaningfully to attempt manipulation of several hundred elections across the United States. American elections are not readily susceptible to manipulation, full stop, thanks to their decentralized nature, strong political norms, and laws protecting the vote. Elections, unlike many other reference markets or events that have CFTC-derivatives trading on them, are governed by multiple law enforcement agencies whose very existence is to prevent and detect election manipulation and fraud. This includes the Federal Election Commission, the federal Department of Justice, state election commissions, state Secretaries of State, and state ethics commissions. History has shown that these agencies are very good at their job.

The only groups that can directly affect the leadership decisions are the U.S. Senate and U.S. House of Representatives. Members of these groups are extremely unlikely to attempt intentional manipulation of the leadership of their chambers merely to settle the contracts a certain way. Their finances are heavily monitored and subject to public disclosure and scrutiny, and Kalshi does not permit them, their close associates, or families to trade, along with numerous other related political actors. Kalshi is taking especially stringent action here, as detailed in Appendix B. Members of Congress also have a sworn duty to represent their constituents and have strong

⁸⁸ Public Comment by Eric Crampton. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69738>.

⁸⁹ Public Comment by Dustin Moskowitz. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69716>.

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incentives not to manipulate electoral processes for private gain. This should clarify any claim that this could de-legitimize elections internal to Congress itself.

Other related officials (like election officials, vote counters) also take such oaths and are heavily monitored because of the strong public interest in maintaining election integrity. In practice, the information gained by being a vote counter is of near-zero marginal value to determining whether or not a given party wins a given chamber of Congress.

As further evidence, consider the history of political control contracts. University of Michigan professor Paul Rhode and Wake Forest professor Koleman Strumpf conducted a systematic review of the history of prediction markets both domestically and abroad, documenting their emergence back to “16th century Italy, 18th century Britain and Ireland, 19th century Canada and 20th century Australia and Singapore.”⁹⁰ In the United States, they were popular from the post-Civil War period until the Great Depression tarnished the image of Wall Street in the public imagination. They wrote,

Although vast sums of money were at stake, we are not aware of any evidence that the political process was seriously corrupted by the presence of a wagering market. This analysis suggests many current concerns about the appropriateness of prediction markets are not well founded in the historical record.⁹²

Prices are not able to be manipulated to the give the false impression of momentum

One may also imagine that a coordinated group of individuals may conspire to manipulate market prices to give the false impression of candidate “momentum,” thus potentially harming the democratic process. This concern has been tested several times by researchers on far smaller markets, who have concluded that all attempts at manipulation have failed.

Koleman and Strumpf in a later paper examined American political prediction markets and found that no previous effort at manipulation was capable of sustaining anything more than fleeting price movements. They wrote, “we find little evidence that political stock markets can be systematically manipulated beyond short time periods.”⁹³ Moreover, the markets examined were much smaller and thus even more prone to manipulation than a fully regulated, liquid market like one offered by a Designated Contract Market. As a result, manipulation on Kalshi’s market is even less plausible. Indeed, as George Mason University professor Robin Hanson and University of California at Santa Barbara professor Ryan Oprea found, one major reason why political

⁹⁰ Paul Rhode and Koleman Strumpf. 2012. “The Long History of Political Betting Markets: An International Perspective.” Strumpf also was a signatory to a supportive public comment. See Public comment 69735. Available at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69735&SearchText>

⁹¹ Paul Rhode and Koleman Strumpf. 2003. “Historical Prediction Markets: Wagering on Presidential Elections”.

⁹² Paul Rhode and Coleman Strumpf. 2003. “Historical Prediction Markets: Wagering on Presidential Elections”.

⁹³ Paul Rhode and Koleman Strumpf. 2005. “Manipulating Political Stock Markets: A Field Experiment and a Century of Observational Data.”

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contracts are resistant to manipulation attempts is that any attempt to manipulate prices induces informed counter-parties to enter on the other side of the market.⁹⁴ In fact, the greater the attempts to push up one side's prices, the greater the returns to becoming an informed trader. As University of Michigan economist Justin Wolfers and Dartmouth economist Eric Zitzewitz wrote regarding previous political contracts, "none of these attempts at manipulation had a discernible effect on prices, except during a short transition phase."⁹⁵ This finding was also supported by over two dozen economists in their 2012 Nadex letter and by many letters supporting Kalshi's submission.⁹⁶⁹⁷

This information—that billions of dollars have been traded on contemporary political control contracts without triggering manipulation—was not available to the Commission the last time it considered similar event contracts in 2012. Although another political contract trading venue, the Iowa Electronics Market, received a no-action letter in 1992, IEM is smaller and harder to access by individuals not associated with the University of Iowa. Now, far more money is known to have been traded on election outcomes without any adverse consequences.

The contracts would combat illegal behavior, improving the perception of election integrity

Americans can also readily access offshore platforms using a virtual private network such as Betfair.⁹⁸ Betfair had more than \$500 million traded on the 2020 election.⁹⁹ These platforms are not registered with the Commission as DCMs, but frequently host such markets. There are no indications that the markets caused or induced an attempt to manipulate elections, let alone a successful manipulation. However, if the Commission is concerned that election markets could nevertheless create election integrity threats, it is imperative to shift trading to an exchange compliant with the Core Principles, with insider trading protections, surveillance, and KYC. In this way, among others, approving the contracts would improve, not harm, election integrity and the perception of it.

The contracts would promote the public perception in election integrity by providing an accurate and competing tool for election forecasting

⁹⁴ Robin Hanson and Ryan Oprea. 2008. "A Manipulator Can Aid Prediction Market Accuracy." *Economica*.

⁹⁵ Justin Wolfers and Eric Zitzewitz. 2006. "Prediction Markets in Theory and Practice".

⁹⁶ Nadex public comment by Zitzewitz et al. Available at <https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/documents/ifdocs/ericzitzewitzltr020312.pdf>.

⁹⁷ For example, the public comment by David Rothschild and company. Available at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69735>.

⁹⁸ Comment letter by policy commentator Matt Bruenig. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69670>.

⁹⁹ Seen at this link:

<https://www.actionnetwork.com/politics/2020-election-odds-trump-vs-biden-presidential-race-sportsbook-rovell>

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Studies consistently show that polarization and partisanship has increased dramatically in the last few decades: every year, greater numbers of people say they believe people from the opposite party are “immoral” and express other hostile sentiments. More concerning than mere hostility is how partisan antipathy can create alternative sets of facts--voters from different parties simply believe two sets of facts about the world. It is from this miasma where conspiracy theories about stolen elections emerge that damage the electoral process.

Prediction markets can help remedy this problem. Economists John Bullock, Alan Gerber, Seth Hill, Gregory Huber conducted an experiment in 2013 and found that partisan gap in beliefs (e.g. if Republicans believe a statement is true with probability 80%, and Democrats believe it with probability 35%, then the partisan gap is 45 percentage points) shrunk by a shocking 55 percent when participants were given a financial incentive for being right.¹⁰⁰ If they were given a lesser financial prize for answering “unsure” (versus none for being wrong and a greater amount for getting it correct), the gap shrunk by about 80 percent.

The reasoning roughly tracks as follows: when no money is at stake, people conflate their beliefs as preferences. For example, a highly partisan liberal may say that a Democratic Party candidate is definitely going to win the 2024 presidential elections this year (a belief), when in reality they merely want the Democrat to win the championship (a preference). However, that same individual when challenged to trade money on that “definite” prediction will re-evaluate and calculate the odds and decide whether or not they should take that trade. In short, when no money is at stake, people express beliefs as mere signaling, lending itself to heavy partisan bias. When money is at stake, they are able to differentiate their beliefs from their preferences. In other words, the partisan reality gap shrinks, and individuals who trade on election markets become more attune to facts and less to partisan groupthink.

In conclusion, the Contract is not contrary to the public interest; rather, it strongly supports the public interest, as demonstrated by the evidence above. The Contract will improve asset pricing, provide risk management opportunities, enhance election integrity and trust, and shift trading activity to regulated exchanges.

B: Addressing objections

Commenters were overwhelmingly in support of Kalshi’s contract; nonetheless, the Exchange takes concerns seriously. Some commenters also raised concern that price manipulation is possible because of insider information. Kalshi maintains that there are near zero actors with inside information on the result of the totality of the elections in the United States House or Senate; nonetheless, in its new submission, Kalshi is proactively prohibiting a host of political

¹⁰⁰ John Bullock, Alan Gerber, Seth Hill, Gregory Huber. 2013. “Partisan Bias in Factual Beliefs about Politics.”

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actors from participating in the markets along with additional surveillance, as listed in Appendix B.

Another concern raised was that, even if the contract does not genuinely make elections more manipulable, it may increase the perception that they are. The Commission must rely on evidence in this sort of deliberation rather than feeling. This perception problem is not an issue in other nations with large-scale election trading (such as the United Kingdom), and in fact, probabilities created by offshore and unregulated exchanges (and discussions of the hundreds of millions traded) are regularly reported on by the political and financial press.¹⁰¹ Election trading is already significant in the United States among large-scale institutions over the counter (as testified to by commenter Angelo Lisboa) and by Americans using offshore/unregulated exchanges as well as by trading indirectly through traditional asset classes.¹⁰² Rather, as discussed at length in Section A of this appendix, the contracts would promote election integrity rather than harm it

A small number of commenters argued that Kalshi's market could have its price manipulated, thus distorting the public perception of a race. The vast majority of these claims are unsubstantiated, though the letter provided by Dennis Kelleher of Better Markets does try and provide some evidence. Specifically, it argued:

The proposed event contract is readily susceptible to manipulation... In her 2009 Harvard Law Review article "Prediction Markets and Law: A Skeptical Account," Professor Rebecca Haw Allensworth detailed how bad actors might manipulate prediction markets: 'Prediction markets are vulnerable to manipulation... First, they could profit by artificially lowering the trading price temporarily and purchasing shares to be sold at a higher price when the market returns to 'normal'. Second, they could try to affect the informational value of the market. For example, a candidate's supporter could purchase his shares at an inflated value, raising the perceived odds that he would win the election, and (hopefully) getting more voters to jump on the putative bandwagon'.¹⁰³

There are several issues with this line of reasoning:

1. Critically, this is a misapplication of the cited research.
 - a. Allensworth only cites one incident of successful manipulation, on an online exchange called TradeSports, referencing the case study on the incident conducted by Paul W. Rhode & Koleman S. Strumpf's, "Manipulating Political Stock

¹⁰¹ There are scores of articles which could serve as examples, but some are: Mashayehki, Rey. "Betting markets called the presidential election more accurately than polls." *Fortune*. 2020. Kirshner, Alex. "How Offshore Oddsmakers Made a Killing off Gullible Trump Supporters." *Slate*. 2020; Yakowicz, Will. "Bettors Have Wagered More Money on Trump vs. Biden Than Nevada Collected During the Super Bowl." *Forbes*. 2020; Bumbuca, Chris. "2020 U.S. presidential election expected to involve more than \$1 billion in wagers." *USA Today*. 2020; Reuters Staff. "Betting markets give Trump slightly improved chances after debate." *Reuters*. 2020.

¹⁰² Public Comment by Angelo Lisboa. Available at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69662>

¹⁰³ Public Comment by Dennis Kelleher. Available at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70788>

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Markets: A Field Experiment and a Century of Observational Data.” However, Rhode and Strumpf conclude the opposite of Allensworth/Better Markets: that even the attempt to manipulate TradeSports’ small, unregulated market only succeeded in changing prices briefly, and conclude, “In the cases studied here, the speculative attack initially moved prices, but these changes were quickly undone and prices returned close to their previous levels. We find little evidence that political stock markets can be systematically manipulated beyond short time periods.”

- b. The other study cited, by Deck et al., does find researchers successfully manipulate a small exchange of *their own creation, with made up assets, with a mere eight traders.*
2. The vast majority of research on this issue demonstrates how shockingly resilient such markets are to manipulation even in spite of no regulation. This is discussed at length also in Appendix G, which details how the Contract is in compliance with Core Principle 3.
 - a. Like Allenworth, Deck et al. acknowledge this.¹⁰⁴ They wrote, “Wolfers and Zitowitz (2004, p. 119) assert that ‘The profit motive has usually proven sufficient to ensure that attempts at manipulating these [prediction] markets were unsuccessful.’ Failed attempts at manipulating markets include political candidates betting on themselves (Wolfers and Leigh 2002) and bettors placing large wagers at horse races (Camerer 1998). Hansen, et al. (2004) did successfully manipulate election prediction markets, but the effects were short lived. In fact, Rhode and Strumph (2009, p. 37) provide an extensive discussion of attempts to manipulate political markets and conclude that ‘In almost every speculative attack, prices experienced measurable initial changes. However, these movements were quickly reversed and prices returned close to their previous levels.’” They go on to cite more experiments that showed resilience to manipulation, including that of Ryan Oprea and Robin Hanson, two supportive commenters.¹⁰⁵ They do not find any research that shows any successful manipulation that is not short-lived.
3. The research cited by Better Markets only focused on small-scale, generally illiquid, unregulated online prediction markets. A highly regulated market that can onboard institutional clients is even less likely to be a victim of a particular manipulator, as markets incentivize speculators to reverse any potential price impact a manipulator could have. Indeed, Hanson and Oprea found, one major reason why political contracts are resistant to manipulation attempts is that any attempt to manipulate prices induces informed counter-parties to enter on the other side of the market. In fact, the greater the attempts to jack up one side’s prices, the greater the returns to becoming an informed trader. As University of Michigan economist Justin Wolfers and Dartmouth economist

¹⁰⁴ Deck, C., Lin, S., & Porter, D. (2010). Affecting policy by manipulating prediction markets: Experimental evidence. ESI Working Paper 10-17.

¹⁰⁵ Hanson, R. and Oprea, R. “A Manipulator Can Aid Prediction Market Accuracy,” *Economica*, 2009, 76, 304-314.

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Eric Zitzewitz wrote regarding previous political contracts, “none of these attempts at manipulation had a discernible effect on prices, except during a short transition phase.” This finding was also noted by over two dozen economists in their 2012 Nadex letter and by many letters supporting Kalshi’s submission.

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APPENDIX F (CONFIDENTIAL) – SOURCE AGENCY

The data which is used to determine the Expiration Value of the Contract is published by the Library of Congress, the official government repository of information for the public since 1800.

Congress.gov is an affiliate of the Library of Congress and contains a record of all members of Congress, their leadership status, and party membership. It updates every weekday morning at 8:00 AM with the complete record of the previous day's activities.

As stated on the Congress.gov website:

Congress.gov is the official website for U.S. federal legislative information. The site provides access to accurate, timely, and complete legislative information for Members of Congress, legislative agencies, and the public. It is presented by the Library of Congress (LOC) using data from the Office of the Clerk of the U.S. House of Representatives, the Office of the Secretary of the Senate, the Government Publishing Office, Congressional Budget Office, and the LOC's Congressional Research Service.

Congress.gov is usually updated the morning after a session adjourns. Consult [Coverage Dates for Congress.gov Collections](#) for the specific update schedules and start date for each collection.

Congress.gov supersedes the THOMAS system which was retired on July 5, 2016. Congress.gov was released in beta in September 2012. The THOMAS URL was redirected to Congress.gov in 2013. The beta label was removed in 2014.

The scope of data collections and system functionality have continued to expand since THOMAS was launched in January 1995, when the 104th Congress convened. THOMAS was produced after Congressional leadership directed the Library of Congress to make federal legislative information freely available to the public.

Congressional documents from the first 100 years of the U.S. Congress (1774-1875) can be accessed through [A Century of Lawmaking](#).¹⁰⁶

¹⁰⁶ <https://www.congress.gov/about>

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The information used to determine the Expiration Value of the Contract is highly visible. Any discrepancy between the true value and the reported values at the Source Agency would be swiftly detected and any individual who engaged in said manipulation of the Source Agency would likely be fired. Importantly, the Exchange has chosen to only use official government sources to determine the Expiration Value of the Contract. The Exchange understands that political control can often be hotly contested, with accusations that an election is improper. Moreover, the Exchange understands that news agencies frequently “call” the results of elections incorrectly. As a result, it does not use any news reporting in our determinations, nor the results of election certifications, as individuals may step down or resign prior to actually taking office. The Exchange thus relies on the official federal government report of who actually took office.

In summary, the data which will be used to determine the Expiration Value of the Contract is prepared by the Library of Congress, the official website of the United States Senate, and the official website of the Clerk of the House of Representatives, in a rigorous manner with multiple layers of checks in place to ensure the highest accuracy possible, and there are robust safeguards against any potential manipulation.

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APPENDIX G (CONFIDENTIAL) – COMPLIANCE WITH CORE PRINCIPLES

Compliance with Core Principles

The Exchange has conducted a comprehensive analysis of the designated contract market core principles (“Core Principles”) as set forth in Part 38 of the Act.¹⁰⁷ The Core Principles relevant to the Contract are outlined and discussed in further detail below:

Core Principle 2 - Compliance with Rules and Impartial Access: The Exchange has adopted the Rulebook, which provides the requirements for accessing and trading on the Exchange. Pursuant to Chapter 3 of the Rulebook, Members must utilize the Exchange’s services in a responsible manner, comply with the rules of the Rulebook (“Rules”), cooperate with Exchange investigations, inquiries, audits, examinations and proceedings, and observe high standards of integrity, market conduct, commercial honor, fair dealing, and equitable principles of trade. Chapter 3 of the Rulebook also provides clear and transparent access criteria and requirements for Exchange Members. Trading the Contract will be subject to all the rules established in the Rulebook, which are aimed at enforcing market integrity and customer protection.

In particular, Chapter 5 of the Rulebook sets forth the Exchange’s Prohibited Transactions and Activities and specifically prescribes the methods by which Members trade contracts, including the Contract. Pursuant to Rule 3.2, the Exchange has the right to inspect Members and is required to provide information concerning its business, as well as contracts executed on the Exchange and in related markets. Chapter 9 of the Rulebook sets forth the Exchange’s Discipline and Rule Enforcement regime. Pursuant to Rule 9.2, each Member is required to cooperate with an Exchange investigation by making their books and records available to the Exchange. The Exchange’s Market Regulation Department performs trade practice surveillance, market surveillance, and real-time market monitoring to ensure that Members adhere to the Rules of the Exchange. The Market Surveillance Department reserves the authority to exercise its investigatory and enforcement power where potential rule violations are identified.

Core Principle 2 also stipulates that an exchange shall establish means to provide market participants with impartial access to the market. Chapter 3 of the Rulebook, and Rule 3.1 in particular, provides clear and transparent access criteria and requirements for Members. The

¹⁰⁷ CFTC Rule 40.2(a)(3)(v) requires a "concise explanation and analysis of the product and its compliance" with core principles. The rule also allows the DCM to incorporate information contained in documents supporting or relied upon to reach these conclusions. We note that we have relied significantly on the rulemaking record for for CFTC Industry Filing 22-022: Review and Public Comment Period of KalshiEx Proposed Congressional Control Contracts Under CFTC Regulation 40.11, available at <https://comments.cftc.gov/PublicComments/CommentList.aspx?id=7311>. As a result, we incorporate the comment file for CFTC Industry Filing 22-022 into this submission.

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Exchange will apply access criteria in an impartial manner, including through the application process described in Rule 3.1.

Core Principle 3 - Contract not Readily Susceptible to Manipulation:

Core Principle 3 and Rule 38.200 provide that a DCM shall not list for trading contracts that are readily susceptible to manipulation. The Exchange's marketplace and contracts, including this Contract, have been designed in accordance with this fundamental principle. The Exchange maintains various safeguards against outcome manipulation and other forms of manipulation, including, (i) automatic trade surveillance and suspicious behavior detection, (ii) Rulebook prohibition, Member certification, and notification, (iii) Member monitoring and know-your-customer verification, and (iv) sanctions. These safeguards render the Contract not readily susceptible to manipulation.

(i) **Automatic trade surveillance and suspicious behavior detection:** The Exchange's trade monitoring and market surveillance systems compute statistics using information from all trades that occur on the Exchange over a range of timeframes, ranging from per trade to the full history of trading activity. These statistics are geared towards identifying unusual trading activity and outlier behaviors. If the trade monitoring and market surveillance system identifies behavior deemed to be unusual, the Exchange's compliance personnel have the ability to investigate and determine applicable sanctions, including limits to or suspension of a Member's access to the Exchange.

(ii) **Rulebook prohibition, member certification and notification:** The Exchange's Rulebook includes various provisions that prohibit manipulative behaviors. As noted above in the discussion of Core Principle 2, the Exchange's Rulebook gives the Exchange the authority to investigate potential violations of its rules. Pursuant to Rule 3.2, the Exchange has the right to inspect Members' books and records, as well as contracts executed on the Exchange and in related markets. Pursuant to Rule 9.2, each member is required to cooperate with an Exchange investigation by making their books and records available to the Exchange for investigation. The Exchange's Market Regulation Department performs trade practice surveillance, market surveillance, and real-time market monitoring to ensure that Members adhere to the Exchange's rules. The Rulebook also imposes sanctions on Members who break rules. Potential penalties include fines, disgorgement, and revocation of membership in Kalshi. Only Members are allowed to trade on the Exchange, and the Exchange requires its Members to strictly comply with the Rulebook. Members cannot complete the account creation process and trade on the Exchange until they certify that they have read the Exchange's rules and agree to be bound by them.

In addition, the Exchange requires applicants for membership to represent and covenant that the applicant will not trade on any contract where they have access to material non-public

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information, may exert influence on the market outcome, or are an employee or affiliate of the Source Agency. In order to further reduce the potential for manipulation, the Exchange maintains a dedicated page on the trading portal that lists all the source agencies and their associated contracts, together with a warning that employees of those companies, persons with access to material non-public information, and persons with an ability to exert direct influence on the underlying of a contract are prohibited from trading on those contracts. This page is intended to serve as an effective means of raising Members' awareness of these rules and prohibitions, further reducing the potential for manipulation. Similarly, the Exchange places a prominent notice on each contract page that notifies Members of the prohibition on trading the Contract while employed by its Source Agency, trading the Contract on the basis of non-public information, and trading the Contract while having the ability to exert influence on the Contract's Market Outcome.

(iii) **Member monitoring and know-your-customer verification ("KYC")**: The Exchange has a robust KYC process. The KYC process is an important tool that helps flag and uncover higher risk traders before they become Members of the platform. The Exchange's KYC process leverages technology to develop a clear and proper understanding of its members, and the various risks they may pose with respect to market integrity and fairness, including manipulation. During the application process, applicants are required to share personally identifiable information, such as their full legal name, identification number, date of birth, and address with the Exchange. Additionally, applicants are required to provide a government issued photo ID (passport, drivers license, etc.) that is used to validate the personally identifiable information shared by the applicant during the application process. Applicant information is run through a comprehensive set of databases that are actively compiled and maintained by an independent third party. The databases are utilized by the Exchange to identify applicants that are employees or affiliates of various governments and other agencies. Moreover, the databases can identify known close relatives and associates of such people as well. Applicants that are flagged go through enhanced due diligence, including manual review, as part of the onboarding process.

Additionally, as part of the KYC process, the Exchange runs applicants through adverse media databases. The adverse media dataset is a real-time structured data feed of companies and individuals subject to adverse media. Monitoring thousands of news sources, business and trade journals, in addition to local, regional and national newspapers, the adverse media feed isolates and highlights any entities or individuals subject to a range of adverse media. The Exchange utilizes the database to trigger enhanced due diligence, because applicants with adverse media may be more likely to engage in certain types of unlawful activity including market manipulation.

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The Exchange engages in active and continuing KYC checks. The KYC checks are initially performed upon application, and the Exchange then monitors its Members on an ongoing basis by running member information through the KYC databases. If material new information concerning an existing Member is at some point added to a database, the Exchange's system will flag the Member even if the cause for the flag was not extant at the time of the Member's application. That Member will then go through enhanced due diligence.

In addition, the Exchange shall engage in an additional three-step protection process.

- a. Before being allowed to participate, market participants must certify that they are not implicated by the prohibition list in Appendix B
- b. Before being allowed to participate, market participants must certify that they do not have access to material nonpublic information
- c. The Exchange's surveillance staff will conduct manual background checks and interviews with the top traders in a market, as well as randomly selected participants, to monitor and enforce the gating rules

(iv) **Sanctions:** Exchange Members must agree to the terms and conditions of the Exchange's Rulebook before being allowed to trade. As a result, Members are subject to disciplinary actions and fines for engaging in improper market conduct that is prohibited by the Exchange's Rulebook. In the event that suspicious trading activity is detected and results in an investigation initiated by the Exchange, market participants are required to provide the Exchange with information relevant to the scope of the investigation under Rule 3.2. Chapter 9 of the Exchange's Rulebook details the process for discipline and rule enforcement. Disciplinary action can range from a letter of warning to fines to referral to governmental authorities that can result in criminal prosecution.

In addition to these global policies and safeguards, there are a number of contract specific attributes and considerations that render the Contract not readily susceptible to manipulation. In addition to these global policies and safeguards, there are a number of contract specific attributes and considerations that render the Contract not readily susceptible to manipulation. Congress.gov is a division of the U.S. Library of Congress with multiple checks on publishing data. For example, given that Congress.gov is publicly available for any Congressional official or member of the public to access, discrepancies between whether an individual has or has not been made leader on Congress.gov (and their party membership) would likely be detected quickly, making manipulation of the website unlikely. In addition to the general availability of Congress.gov, the Contract relates to a high-profile event, which is the subject of immense media coverage and interest. Thus, any attempt to publish incorrect data would be quickly noticed and identified. The negative consequences that Library of Congress staff would likely face for

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publishing incorrect data in order to intentionally manipulate the market would also serve as a strong disincentive from attempting manipulation.

With regard to possible outcome manipulation, it is clear that the totality of U.S. Congressional elections are not readily susceptible to manipulation. The only groups that can directly affect the leadership decisions are the U.S. Senate and U.S. House of Representatives. Members of this group are extremely unlikely to attempt intentional manipulation of the leadership of their chambers to settle the Contract a certain way--the economic and political ramifications of which are far greater than the position limits on the Exchange. Instead of considering the potential outcome of the Contract on the Exchange, legislators involved with the confirmation are more likely to incorporate other factors into their decision-making process, such as political circumstances. The weight of these factors is much greater than any consideration of a market on the Exchange - thus manipulation for the sole purpose of influencing the outcome of the Contract is unlikely. The amount of media attention and financial reporting done on potential changes in leadership means that opportunistic attempts to manipulate reporting to affect prices is likely to be ignored given the amount of attention given to the subject. Members of Congress also have a sworn duty to represent their constituents and would not manipulate Congressional processes for private gain. Their finances are also heavily monitored and subject to public disclosure and scrutiny.

Moreover, election officials swear an oath to faithfully uphold the results of the elections. Tampering with federal elections is a serious federal crime and the consequences of violating would be quite severe. Vote counting is also supervised by trained members of both parties, whose incentive is to detect any deviation or error. In addition, any close election results in a recount, and therefore any manipulation by an individual or small group of individuals could reasonably be expected to be detected.

As further evidence, consider the history of political control contracts. University of Michigan professor Paul Rhode and Wake Forest professor Coleman Strumpf conducted a systematic review of the history of prediction markets both domestically and abroad, documenting their emergence back to “16th century Italy, 18th century Britain and Ireland, 19th century Canada and 20th century Australia and Singapore.”¹⁰⁸¹⁰⁹ In the United States, they were popular from the post-Civil War period until the Great Depression tarnished the image of Wall Street in the public imagination. They wrote,

Although vast sums of money were at stake, we are not aware of any evidence that the political process was seriously corrupted by the presence of a wagering market. This

¹⁰⁸ Paul Rhode and Coleman Strumpf. 2003. “Historical Prediction Markets: Wagering on Presidential Elections”.

¹⁰⁹ Paul Rhode and Coleman Strumpf. 2012. “The Long History of Political Betting Markets: An International Perspective.”

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analysis suggests many current concerns about the appropriateness of prediction markets are not well founded in the historical record.¹¹⁰

Today, election trading is alive and well in other democracies like the United Kingdom, without documented attempts at—let alone successful—manipulation. Any effort to coordinate votes for the sake of the Contract would take significant planning and coordination, and is unlikely to occur because none can know beforehand what the margin of victory is going to be. Accordingly, the organizers would have no way of knowing the size of the conspiracy they would need to orchestrate. Such an attempt would be implausible. Large-scale coordination of sufficient volume to affect an election of even a few hundred thousand voters (as exists in the smallest states or mid-size cities) would be too large to avoid scrutiny from market surveillance and counter-partisan mobilization. Nearly every commodity market can be altered if tens to hundreds of thousands of people all conspire simultaneously; however, it is nearly impossible to coordinate across tens of thousands of individuals without being visible. If this was a viable path, then highly motivated partisans would already attempt to do so and profit from the myriad ways they could profit by knowing the outcome of an election beforehand. The reason this type of criminal activity does not occur is that such a scheme would be readily detected.

One may also imagine that a coordinated group of individuals may conspire to manipulate market prices to give the false impression of candidate “momentum”, thus potentially harming the democratic process. This concern, too, is empirically implausible. Coleman and Strumpf in a later paper examined previous American political prediction markets and found that no previous effort at manipulation were capable of sustaining anything more than fleeting price movements. They wrote, “we find little evidence that political stock markets can be systematically manipulated beyond short time periods.”¹¹¹ Moreover, the markets examined were much smaller and thus even more prone to manipulation than a fully regulated, liquid market like a DCM. As a result, the probability of manipulation is implausible. Indeed, as George Mason University professor Robin Hanson and University of California at Santa Barbara professor Ryan Oprea found in one paper, one major reason why political contracts are rather invulnerable to manipulation attempts is that any attempt to manipulate prices induces informed counter-parties to enter on the other side of the market.¹¹² In fact, the greater the attempts to jazz up one side’s prices, the greater the returns to becoming an informed trader. As University of Michigan economist Justin Wolfers and Dartmouth economist Eric Zitzewitz write regarding previous political contracts, “none of these attempts at manipulation had a discernible effect on prices, except during a short transition phase.”¹¹³

¹¹⁰ Paul Rhode and Coleman Strumpf. 2003. “Historical Prediction Markets: Wagering on Presidential Elections”.

¹¹¹ Paul Rhode and Coleman Strumpf. 2005. “Manipulating Political Stock Markets: A Field Experiment and a Century of Observational Data.”

¹¹² Robin Hanson and Ryan Oprea. 2008. “A Manipulator Can Aid Prediction Market Accuracy.” *Economica*.

¹¹³ Justin Wolfers and Eric Zitzewitz. 2006. “Prediction Markets in Theory and Practice”.

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There are also legal protections against disrupting or pressuring the voting process of others. For example, the secret ballot is a guaranteed right in the vast majority of state constitutions, and statutorily protected in the rest.

The lack of substantiated attempts at manipulation of political control contracts by such methods is quite telling in the context of how much is already at stake in American elections. The economic impacts of elections themselves dwarf the value of Kalshi's contracts many, many times over. Likely trillions in stock value are deeply dependent on elections; entire sectors, firms, and places can be favored by a candidate for office; and almost every actor in the economy is directly affected by tax rates. The marginal addition of Kalshi's contract will not change whether or not elections are events of enormous consequence, and thus not increase anyone's incentive meaningfully to attempt manipulation of several hundred elections across the United States. American elections are not readily susceptible to manipulation, full stop, thanks to their decentralized nature, strong political norms, and laws protecting the vote. Elections, unlike many other reference markets or events that have CFTC-derivatives trading on them, are governed by multiple law enforcement agencies whose very existence is to prevent and detect election manipulation and fraud. This includes the Federal Election Commission, the federal Department of Justice, state election commissions, state Secretaries of State, and state ethics commissions. History has shown that these agencies are very good at their job.

Importantly, the fact that these contracts have already been *trading* on venues in the United States by Americans should demonstrate that they do not cause manipulation and that the markets are safe. In 2014, the Commission granted PredictIt, a new unregistered trading venue dedicated to election and political event contracts, a no-action letter. Since then, PredictIt has traded more than one billion shares.¹¹⁴ This information--that billions of dollars can be traded on contemporary exchange-traded political control contracts without creating manipulation concerns--was not available to the Commission the last time it considered similar event contracts in 2012.¹¹⁵ Election trading is also common over-the-counter in the United States among the largest financial institutions and high net worth individuals.¹¹⁶

Americans can also readily access cryptocurrency-based decentralized exchanges (DEXes) which offer political control markets on platforms such as Polymarket and Omen.¹¹⁷¹¹⁸

¹¹⁴ PredictIt.

<https://www.predictit.org/insight/aHR0cHM6Ly9hbmFseXNpcy5wcmVkaWN0aXQub3JnL3Bvc3QvMTg4NzQ3ODgwMDQzL2EtcHJIZGljdGFibGUtbnV3c2xldHRlci0xMTEwOSNtb2JpbGU=>

¹¹⁵ Nadex order. 2012. CFTC.

<https://www.cftc.gov/sites/default/files/idc/groups/public/@rulesandproducts/documents/ifdocs/nadexorder040212.pdf>

¹¹⁶ Public Comment by Angelo Lisboa. Available at:

<https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69662>

¹¹⁷ Polymarket. <https://polymarket.com/market/will-gavin-newsom-be-governor-of-california-on-december-31-2021>

¹¹⁸ Omen.eth. <https://omen.eth.link/#/0x95b2271039b020aba31b933039e042b60b063800/finalize>

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Polymarket's markets on Congressional control have traded millions.¹¹⁹ In total, more than half of volume ever traded on Polymarket (north of \$50,000,000) were traded on election-related markets. These platforms are not registered with the Commission as Designated Contract Markets (DCMs), but frequently host such markets. Despite the CFTC's January 2022 order against Polymarket, it is still readily accessible by Americans via VPN. Betfair had more than \$500 million traded on the 2020 election.¹²⁰ There are no indications that the markets caused or induced an attempt to manipulate elections, let alone a successful manipulation.

With regards to possible price manipulation, in practice, there are few actors who hold meaningful non-public information that could affect the value of the Contract. Nonetheless, Kalshi is taking a large step to prohibit a large number of political actors from participating in the contract. Further, as part of the Exchange's KYC verification and monitoring system, the Exchange also cross-checks applicants against comprehensive databases. In particular, the Exchange will check whether any Members trading on this Contract are on databases of Politically Engaged Persons. The Exchange further cross checks applicants against databases of family members and close associates of Politically Engaged Persons. These checks help to further reduce the potential for trading violations and further increase the integrity of this Contract.

Core Principle 4 - Prevention of Market Disruption: Trading in the Contracts will be subject to the Rules of the Exchange, which include prohibitions on manipulation, price distortion, and disruption to the cash settlement process. Trading activity in the Contract will be subject to monitoring and surveillance by the Exchange's Market Surveillance Department. In particular, the Exchange's trade surveillance system monitors the trading on the Exchange to detect and prevent activities that threaten market integrity and market fairness including manipulation, price distortion, and disruptions of the settlement process. The Exchange also performs real-time market surveillance. The Exchange sets position limits, maintains both a trade practice and market surveillance program to monitor for market abuses, including manipulation, and has disciplinary procedures for violations of the Rulebook.

Core Principles 7 and 8 - Availability of General Information and Daily Publication of Trading Information: Core Principles 7 and 8, implemented by Regulations Sections Subsections 38.400, 38.401, 38.450, and 38.451, require a DCM to make available to the public accurate information regarding the contract terms and conditions, daily information on contracts such as settlement price, volume, open interest, and opening and closing ranges, the rules, regulations, and mechanisms for executing transactions on or through the facilities of the contract market, and the rules and specifications describing the operation of the contract market's electronic matching platform.

¹¹⁹ Polymarket. <https://polymarket.com/market/will-trump-win-the-2020-us-presidential-election>

¹²⁰ Seen at this link:

<https://www.actionnetwork.com/politics/2020-election-odds-trump-vs-biden-presidential-race-sportsbook-rovell>

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Rule 2.17 of the Rulebook sets forth the rules for publicizing information. The Rulebook and the specifications of each contract are made public on the Exchange website and remain accessible via the platform. The Exchange will post non-confidential materials associated with regulatory filings, including the Rulebook, at the time the Exchange submits such filings to the Commission. Consistent with Rule 2.17 of the Rulebook, the Exchange website will publish contract specifications, terms, and conditions, as well as daily trading volume and open interest for the Contract. Each contract has a dedicated “Market Page” on the Kalshi Exchange platform, which will contain the information described above as well as a link to the Underlying used to determine the Expiration Value of the Contract. Chapter 5 sets forth the rules, regulations and mechanisms for executing transactions, and the rules and specifications for Kalshi’s trading systems.

Core Principle 11 - Financial Integrity of Transactions: Each Member must be in good standing and in compliance with the Member eligibility standards set forth in Chapter 3 of the Rulebook. All contracts offered by the Exchange, including the Contract, are cleared through the Clearinghouse, a Derivatives Clearing Organization (“DCO”) registered with the CFTC and subject to all CFTC Regulations related thereto. The Exchange requires that all trading be fully cash collateralized. As a result, no margin or leverage is permitted, and accounts must be pre-funded. The protection of customer funds is monitored by the Exchange and ensured by the Clearinghouse as “Member Property.”

All Remaining Requirements: All remaining Core Principles are satisfied through operation of the Exchange’s Rules, processes, and policies applicable to the other contracts traded thereon. Nothing in this contract requires any change from current rules, policies, or operational processes.

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**APPENDIX H (CONFIDENTIAL) – COMPLIANCE WITH THE CONTRACT
VETTING FRAMEWORK**

As part of its registration as a Designated Contract Market, the Exchange submitted a Contract Vetting Framework (CVF) through which all contracts would have to be vetted against in order to be eligible for self-certification. At designation, the CVF prohibited contracts on the outcomes of United States political elections. Since then, Kalshi submitted an amendment to the CVF permitting it to self-certify contracts related to partisan political control of the House and Senate which was approved by the Commission.

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APPENDIX I (CONFIDENTIAL) – DIRECTLY ADDRESSING COMMISSION QUESTIONS

The Commission asked for public input on seventeen questions. These seventeen questions can be broadly categorized into five distinct categories of questions. These are:

1. Whether Kalshi’s contract triggers one of the prongs of CFTC Regulation 40.11 or CEA 5c(c)(5)(C), in particular, “gaming” and “activity illegal under state law”; (questions 1-4)
2. Whether Kalshi’s contract is distinct from Nadex’s 2011 contract submission; (question 5)
3. Whether Kalshi’s contract would provide economic utility to market participants; (questions 6-11)
4. Whether Kalshi’s contract would serve the public interest; and (questions 12-14, 17)
5. Whether and how Kalshi’s contract can be readily subject to manipulation. (questions 15 and 16)

In developing the CONTROL contract, the Exchange carefully considered both the Commission’s questions on the prior submission, as well as the public’s input on the prior submission. The public’s input formed a bedrock of the Exchange’s determination, together with its own analysis, that the contracts are consistent with the CEA and valid Commission Regulations. The Exchange summarizes some of the comments below, and incorporates the entire comment file from the original submission by reference. (The CFTC’s comment file is available here: <https://comments.cftc.gov/PublicComments/CommentList.aspx?id=7311>).¹²¹ The Exchange considered all of the comments in full in developing this contract, and the comment record is an important part of this contract. The Exchange notes that all the comments are in the Commission’s possession, and are in fact electronically searchable on the Commission’s website.

One: does Kalshi’s contract trigger one of the prongs of CFTC Regulation 40.11 or CEA section 5c(c)(5)(C), in particular, gaming and unlawful activity? (questions 1-4)

The public comments largely stated that the answer is no, the proposed contract does not involve, relate to, or reference gaming, or any of the other prongs of CEA 5c(c)(5)(C) or Regulation 40.11. Commenters noted that elections do not involve, relate to, or reference gaming or gambling. Rather, elections are events of incredible and far-reaching economic impact. Kalshi’s

¹²¹ CFTC Rule 40.2(a)(3)(v) requires a “concise explanation and analysis of the product and its compliance” with core principles. The rule also allows the DCM to incorporate information contained in documents supporting or relied upon to reach these conclusions. We note that we have relied significantly on the rulemaking record for CFTC Industry Filing 22-022: Review and Public Comment Period of KalshiEx Proposed Congressional Control Contracts Under CFTC Regulation 40.11, available at <https://comments.cftc.gov/PublicComments/CommentList.aspx?id=7311>. As a result, we incorporate the comment file for CFTC Industry Filing 22-022 into this submission.

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contract would also not involve, relate to, or reference unlawful activity. A contract on election outcomes would provide market participants with a powerful tool to hedge political risk.

The underlying assumption of the Commission's question is that in considering CEA 5c(c)(5)(C) or Regulation 40.11, one should consider not only whether the contract's subject involves gaming (e.g. a contract like "Will the roulette ball fall on white or red?"), but rather, whether the act trading on the contract *itself* constitutes gaming. The commenters noted that this is an incorrect application of the statute. This is evidenced by the fact that the other items of the list (assassination, murder, war) are clearly referring to the underlying event, not the act of trading. If that reading were correct, it would make the enumerated categories of terrorism, assassination or war superfluous, as clearly trading on such events would also be gaming. This argument, in particular, is made by comments from both of the last two General Counsels of the CFTC as well as other law firms such as Jones Day and Tabet DiVito & Rothstein.¹²²

With regard to unlawful activity, commenters noted that, unlike gambling offerings, Kalshi's contract is a federally regulated derivative product and is exempted from the federal interstate betting prohibition and state laws that prohibit gambling. Thus, the existence of state laws that prohibit 'gambling' on election outcomes does not confer an involvement with illegal activity on Kalshi's contract anymore than the existence of state laws that prohibit 'gambling' confer an involvement with illegal activity onto any event contract or derivatives product. The letter submitted by Better Markets, arguing that Kalshi's contract does trigger a prong of 40.11/5c(c)(5)(C), relies on the false idea that Kalshi's contracts certified with the Commission are subject to the Unlawful Internet Gambling Enforcement Act, when CFTC products are expressly carved out of such regulations.¹²³¹²⁴ The Exchange rejects this comment as being patently legally incorrect, and the Exchange's position is supported by the legal analysis of the Commission's most recent two general counsels attached as part of Appendix M.

Commenters further informed the Commission that it should not consider the presence of election outcomes in gaming venues such as casinos. They noted that the question is not relevant to the particular contracts as such contracts not available on any legal American sportsbook, and that the Commission precedent contradicts such consideration, as this standard was not even applied by the Commission when considering contracts on the outcomes of sports games in *ErisX* and was not considered in *Nadex*.

¹²² Public Comments 70781, 69737, and 70765.

¹²³ Public Comment by Dennis Kelleher, available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70788>

¹²⁴ The Unlawful Internet Gambling Enforcement Act of 2006 "do[es] not include...any transaction conducted on or subject to the rules of a registered entity or exempt board of trade under the Commodity Exchange Act". 31 U.S.C. § 5362(1)(E) (2006).

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Commenters also pointed out that there is either a conflict between Regulation 40.11 and the CEA with respect to the breadth of the special rule, as former Commissioner Quintenz noted, or Regulation 40.11 does not prohibit any contracts, as former Commissioner Berkovitz assumed in his statement on *ErisX*.

Commenter Richard Sandor, the “father of futures” who developed the first interest rate products, informed the Commission that financial speculation is not the same as gambling. Gregory Kursek, who led the DMO’s Product Review Branch, did the same.

Some commenters argued that the contract is related to gaming because the contract would not serve an economic purpose. That is addressed in Appendix B.

The foregoing analysis and public comments support the conclusion that the question of CEA 5c(c)(5)(C) or Regulation 40.11 is answered in the negative. In Kalshi’s new submission, it increased the contract order size (to purchases in 5,000 contract multiples) and increased the position limits for parties with *bona fide* hedging need to reduce the ease of low-value speculative behavior relative to hedging behavior. Accordingly, the Exchange has determined that the contract is not inconsistent with either CEA 5c(c)(5)(C) or Regulation 40.11, a conclusion that is strongly supported by the information from the public that the Commission requested.

Two: is Kalshi’s contract distinct from Nadex’s 2011 contract submission? (question 5)

Kalshi has provided a separate document that details the distinctions between Nadex’s contract submission and Kalshi’s new contract. However, even with regards to Kalshi’s original submission, commenters such as former CFTC Chairman Mark Wetjen who was on the Commission when the *Nadex Order* was released, and former CFTC Deputy Director of Product Review Greg Kuserk, noted the changes in circumstances since Nadex’s 2011 submission that also justify looking and considering the contract, its public impact, and the role of gaming, differently. These circumstances include the success of other electoral markets that the Commission has approved of (PredictIt, hosted by Victoria University of Wellington) and the increasing salience of electoral risk on market participants. In light of these changes, they informed the Commission that it would be inappropriate to rotely prohibit the original submission on the grounds of a non-regulatory, contract specific conclusion from a decade ago. The correct conclusion now is for the contract to be allowed by the Commission. In light of these comments, and the material and significant economic differences between the contracts at the subject of the *Nadex Order* and the current contract, among other salient points of black-letter settled administrative law, the Exchange determined that the contract is consistent with the CEA and Regulations and is not in any way prohibited by *Nadex*.

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Three: Would Kalshi's contract provide economic utility to market participants? (questions 6-11)

In its submission, which is publicly available, Kalshi provided evidence—from decades of academic research, business testimony, the public press, and policymakers—that partisan election outcomes have consistent and predictable effects on the values of assets, prices of services, and economic activity more broadly. Commenters overwhelmingly agreed, including (though hardly limited to) academics such as Nobel Laureate Robert Shiller and former Chair of the Council of Economic Advisors Jason Furman; former policymakers former SEC Commissioner Joseph Grundfest and former CFTC Commissioner Mark Wetjen; and members of private industry, such as AB-inBev board member Jorge Paulo Lemann (a major participant in extant agricultural futures), the CEO of Continental Grain Company Paul Fribourg, and Susquehanna International Group Head of Strategic Planning David Pollard.¹²⁵ Angelo Lisboa, a Managing Director of J.P. Morgan argued that large institutions already trade such products over-the-counter.¹²⁶ The public press and private businesses routinely discuss how election outcomes are traded significantly through other exchange-traded assets, like stocks.

In the public comment process, many businesses and business leaders, in industries such as energy, cannabis, and finance, testified to their personal hedging needs and use cases for the contract.

Some commenters argued that the contract would not serve their own hedging needs, or speculated that it would not serve the needs of others. The fact that a contract would not help a particular commenter's hedging needs is not relevant to whether it would serve those of others. The uninformed and speculative bets of commenters cannot form the basis of any reasoned decision making by a government agency. This would be black-letter administrative law in a vacuum. In the face of the overwhelming majority of commenters who informed the Commission about their own hedging utility and the overwhelming evidence that elections have economic consequences, these speculative comments contradict reality.

In one of its questions, the Commission asked specifically if election impacts are sufficiently predictable—even if they have a large impact—to justify a hedging product. Commenters argued that this is not a standard found in law, regulation, or in any previous decision or consideration. They further noted that the question of how to hedge is not the province of the Commission. The job of the Commission is not to determine whether a hedge is a “good” or not; that is for the market and its participants to decide. The Commission does not want to find itself in the business of grading participants' hedging strategies. The Commission would never be called to testify in a

¹²⁵ Public Comments 70761, 69708, 69695, 70771, 69684, 69727, and 70743.

¹²⁶ Public Comment by Angelo Lisboa. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69666>.

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shareholder suit against a company because the company's hedging strategy was unsuccessful. Rather, the market should determine whether a given contract is appropriate for their risk.

It is important to acknowledge that the comments did not at all agree that the notional value of the contract impacts the analysis at all, and this is for many reasons. These include the understanding that retail participants have economic needs that the Commission should not discriminate against. Also, the Commission has embraced contracts like micro bitcoin contracts and it is incongruous to assume a different economic reality for these contracts.

Commenters also noted that hedging does not require a 1:1 hedge against a specific asset; hedging is a means of risk management, and the contracts can be used to manage risk from elections. This hedging truth is recognized in the numerous contracts that the Commission has embraced such as weather and many other contracts that either do not have 1:1 hedging use or where 1:1 hedging is overwhelmingly not the primary use of the contract.

Commenters also noted that the contracts have economic utility well beyond hedging. Hedging, after all, is only one of the twin pillars of economic utility. The second pillar is price basing, and the contracts have significant price basing utility. It is nigh axiomatic that there is utility in pricing risk that affects assets, service agreements, and other economic utility. These contracts do exactly that.

Based on the information from the public, as well as the clear evidence of the impact of elections (just watch the news during elections), the Exchange concluded that the contract has economic utility, both hedging and price basing. This is certainly true for the current submission which has a significantly increased order size (to purchases in 5,000 contract multiples) and increased position limits for parties with *bona fide* hedging utility.

Four: Would Kalshi's contract serve the public interest? (questions 12-14, 17)

Commenters agreed that Kalshi's contract would serve the public interest. In addition to the public interest by virtue of its hedging and price basing functions, the Contract will generally provide a valuable forecasting tool that complements existing polling and other forecasting tools. Accurate data regarding the state of elections is very socially valuable and sought after, prompting the development of advanced polling and analytics publications like *FiveThirtyEight*. In addition, former Chair of the Council of Economic Advisors Jason Furman detailed in his comment how political markets, even on a limited basis, had informational value that were used even in the Obama White House.¹²⁷ Eric Crampton wrote about how New Zealand political

¹²⁷ Public comment letter by Jason Furman. Available at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69708>.

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markets were used by their country's central bank.¹²⁸ By providing an alternative, and possibly more accurate (certainly faster) forecast of an election outcome to polls, Kalshi's contract would enrich the public discourse through an unbiased, decentralized prediction of the future. Others, such as OpenPhilanthropy founder Dustin Moskovitz, emphasized how he could use the market to help influence future decision making with regards to politics.¹²⁹

A small number of commenters argued that Kalshi's contract could distort the electoral process if the contracts were manipulated. These comments ignored PredictIt, which has traded more than a billion dollars—sans hedging—without any such issues; it ignores how banks and financial institutions already trade these products; and how many other nations (such as the United Kingdom, Canada, Ireland, Australia, and other liberal democracies) have large outright gambling on electoral outcomes without any documented harm. Importantly, they ignored both the evidence that markets like the Contract are very difficult to manipulate and the Exchange's surveillance system that would further make manipulation extremely unlikely. Further, as other commenters noted, the Contract would provide a source of information that is much less likely to be manipulated than polling, media, advertising, and social media.

The Exchange notes that the prior submission and the Commission's questions received significant press attention from many different news sites. The commenters included individuals, businesses of all sizes, and many experts in their fields. In light of the commenters support on the Contract's social value, highlighting the real world evidence and utilization of the contracts, and the defects with the few comments that speculated about a public harm, the Exchange has concluded that the public has spoken to its interests, and these contracts are in the public's interest.

Five: Would Kalshi's contract be readily susceptible to manipulation, and how should it protect against it? (questions 15 and 16)

Several commenters, including commenters with extensive expertise in the industry and in detecting fraud and manipulation, noted how there is little to no ability for individuals to either manipulate the outcomes of hundreds of Congressional elections or to manipulate the contract's price because of insider information. There are enormous incentives in the status quo for individuals to try and do so, without any success. American elections are not readily susceptible to manipulation, and neither is Kalshi's contract.

Kalshi, however, takes the threat of even a marginal or unexpected case seriously, and in its new submission has clarified how it will treat politically associated individuals. Kalshi preemptively

¹²⁸ Public Comment by Eric Crampton. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69738>.

¹²⁹ Public Comment by Dustin Moskovitz. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69716>.

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runs users through a list of politically exposed persons and will ban such individuals from trading. Before being allowed to participate on a political risk market, participants will be required to certify that they are not affiliated with any campaign, PAC, or political party, and do not have any insider information on the matter. Kalshi's surveillance team will conduct manual background checks and interviews with the top traders in a market, as well as randomly selected participants, to monitor and enforce the gating rules. Kalshi will also provide the Commission with additional reporting that the Commission determines would assist with regulating this specific market.

The letter provided by Better Markets cites two studies which argue prediction markets can be manipulated (though not necessarily readily, which the Exchange notes is the standard of law). One of these cites a manipulation attempt on a small, online exchange in the early 2000s that is swiftly corrected by other traders. The other refers to a market created by academics with only eight participants and fake funds. Unlike many of the underlying markets the CFTC monitors, American elections have dedicated enforcement agencies (such as the Federal Election Commission) and have never been manipulated. Consequently, dozens of economists, including major policymakers and a Nobel Laureate, wrote comments arguing specifically that these contracts are not readily susceptible to either outcome or price manipulation.

In light of the many factual and analytical deficiencies in Better Markets' comment, and the overwhelming information from commenters with actual market and economic experience that the contracts are not readily susceptible to manipulation, and the extra protections that the Exchange will adopt to go above and beyond, the Exchange has determined that the contracts are not readily susceptible to manipulation.

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APPENDIX J (CONFIDENTIAL) – COMPARISON WITH NADEX SUBMISSION

The proposed new terms of the Political Control contract differ significantly and materially from the *Nadex Order* contract, which was disallowed by Commission Order in 2012. The table below highlights those differences by comparing the Nadex contract, the withdrawn Political Control Contract (“CONGRESS”), and the proposed Political Control contract (“CONTROL”). The proposed new terms are designed to provide a tool to shift economic risk tied to political elections and to be utilized by firms, industry, and other traditional participants in derivatives markets.¹³⁰

Contract attribute	Nadex	CONGRESS contract	CONTROL contract
Order size	1 \$100 contract	1 \$1 contract	5,000 \$1 contracts; functionally \$5,000 notional value
Position limit	2,500 contracts	\$25,000	Tiered, up to \$100M for ECPs with a <i>bona fide</i> hedging need

These changes will significantly alter the way that the market will participate in the contract. Even though order sizes are not considered material with regard to the “equivalent swap” analysis under the Position Limits Rule, codified in Regulation 150.1, that analysis is not relevant to the analysis here. The policy and purpose of economic equivalency for position limits is stated by Congress as being necessary to “to (i) Diminish, eliminate, or prevent excessive speculation; (ii) deter and prevent market manipulation, squeezes, and corners; (iii) ensure sufficient market liquidity for *bona fide* hedgers; and (iv) ensure that the price discovery function of the underlying market is not disrupted.” Those factors are very different from the factors that were considered in *Nadex*, namely the application of CEA section 5c(c)(5)(C) and Regulation 40.11. The relevant factors that the Commission considered in *Nadex* were the nature of how market participants will use the contract, and the economic attributes of a contract such as notional size is highly material to that question.

In fact, the Commission intuited that economic attributes such as notional size are important to the analysis and specifically asked a number of questions directly and indirectly to the public about the Contract’s size in its questions regarding Kalshi’s CONGRESS submission. The comments in response to the Commission’s question all indicated that the economic attributes of the contract *should* be considered (most argued that the original contract passed any economic

¹³⁰ Although the contract is available for trading by all Exchange members, as required under the CEA and Core Principle 2.

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utility test, of course; *a fortiori* the new contract passes the same tests). Accordingly, the Exchange notes that the current submission is distinguishable from the contracts that were the subject of the *Nadex* order, a point that is strongly buttressed by the public comments that the Commission requested.

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**APPENDIX K (CONFIDENTIAL) – ADDITIONAL CORE PRINCIPLE 3
CONSIDERATIONS**

The CONTROL contract is not readily susceptible to manipulation. There are robust protections against manipulation. The Exchange has rules that prohibit manipulative trading, and the Exchange performs surveillance to detect manipulation. This serves as a deterrent to attempts to manipulate the market via manipulative trading. In addition, the Exchange’s rules also prohibit trading on non-public information, and the Exchange performs surveillance to detect violations of this rule. The Exchange is also adopting contract specific gating rules that further buttress this rule. Specifically:

- a. Before being allowed to participate, market participants must certify that they are not implicated by the prohibition list in Appendix B
- b. Before being allowed to participate, market participants must certify that they do not have access to material nonpublic information
- c. The Exchange’s surveillance staff will conduct manual background checks and interviews with the top traders in a market, as well as randomly selected participants, to monitor and enforce the gating rules

The Exchange will be surveilling its market for any sign of trading that is indicative of manipulative or fraudulent behavior. The Commission will have all of the necessary data to do the same, should it so wish.

As discussed at length in Appendices E and F, American elections are not readily susceptible to manipulation. In fact, manipulation of which party controls the U.S. Congress has never occurred. This is in contrast to existing markets that the CFTC regulates. Indeed, the CFTC has brought numerous enforcement actions against market participants who either manipulated or attempted to manipulate markets in oil, precious metals, cattle, and other commodity spot and futures markets. The Commission regularly brings almost a hundred enforcement actions per year and orders billions in monetary relief. Then, of course, there are digital asset markets, where the Commission has brought dozens of actions in an incredibly short time. Contrast that with elections, where election or voter fraud is extremely rare, and never succeeds at flipping the outcome of which party controls Congress. Even in cases where election manipulation has been attempted, it has only succeeded in affecting extremely small, local elections.¹³¹

Election manipulation is a crime.¹³² There are law enforcement agencies who police elections, and elections are policed much more effectively than other markets that have CFTC derivative products trading on them. Any attempt to manipulate the contract would most certainly involve a high degree of speculation; the contract is in regard to the sum of hundreds of elections. It is not

¹³¹ <https://www.brennancenter.org/our-work/research-reports/truth-about-voter-fraud>

¹³² <https://www.fbi.gov/how-we-can-help-you/safety-resources/scams-and-safety/common-scams-and-crimes/election-crimes-and-security#:~:text=Intentionally%20deceiving%20qualified%20voters%20to,%2Fhow%2Dto%2Dvote.>

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even possible to determine which elections will be the closest (and thus easiest to affect) in advance, even if some races are understood to be more close than others. As detailed in Appendix F, a large-scale conspiracy to coerce many individuals to vote a particular way across many different jurisdictions without being detected. A fraud of sufficient size would mean that this fraud is no *Ocean's 8*, or even *Ocean's 11*. You'd be looking at Ocean's-well-into-the-hundreds-if-not-hundreds-of-thousands. Manipulation of polling machines themselves is equally quixotic.¹³³ Taken all in all, it is very unlikely that a fraud pertaining to this contract will be attempted, and considerably less likely than in other areas that fall under the Commission's enforcement authority.

Additionally, concerns regarding policing election fraud are absent from, and foreign to, the CEA's goal of fostering innovation and trading on American markets. The Commission is not the only "cop on the beat" with regard to election fraud. Elections, unlike many other reference markets or events that have CFTC-derivatives trading on them, are governed by multiple law enforcement agencies whose very existence is to prevent and detect election manipulation and fraud. This includes the Federal Election Commission, the federal Department of Justice, state election commissions, state Secretaries of State, and state ethics commissions. History has shown that these agencies are very good at their job.

Critically, there are already enormous stakes in U.S. elections, creating incentives for outcome manipulation; this contract will not change that fact. As discussed in extensive detail in Appendix B, in the public comments, and to anyone involved in industry, elections move prices and it is specious to presume that they do not. Wall Street firms and global finance all trade elections. The contract before the Commission is not novel in that regard; rather, it is a more efficient instrument than what firms currently use to take positions on elections.

¹³³ <https://www.washingtonpost.com/politics/2022/11/01/truth-about-election-fraud-its-rare/>

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APPENDIX L (CONFIDENTIAL) – THE IMPORTANCE AND SALIENCE OF CLIMATE RISK TO POLITICAL RISK CONTRACTS

Climate Risk Exposure

The CFTC’s Market Risk Advisory Committee published a seminal report on managing climate risk in the United State’s financial system (“Report”).¹³⁴ The Report cogently described the urgency for the financial markets, and financial regulators, to enhance the existing climate risk management framework, in part because of the impossibility of predicting with any precision how climate change will impact participants, including economically. The Report explains how participants should translate climate risk into economic terms, and then once translated, derivatives can be used to manage that risk.

As the Report explains, risk is a composite measure of exposure, sensitivity and, in this case, the adaptive capacity of a firm to manage the climate risks of a particular asset. Exposure reflects the presence of financial assets coinciding with climate impacts—namely acute extreme events or recognizable patterns of stress, which includes the likelihood of an economically harmful incident occurring. Exposure is the prerequisite to the transmission of climate risks to financially relevant metrics. Sensitivity reflects a measure of the responsiveness of exposed assets to any given shock or stress. In other words, risk is the product of the potential economic impact of an event and the likelihood of that event occurring. Because risk is technically a probabilistic function of sensitivity and exposure, the novelty of climate change means that there is greater uncertainty and ignorance about the range of possible outcomes and the Report recommends the use of a variety of tools to overcome this uncertainty, such as scenario analysis. This method of risk management is key to effectively managing climate risk. If market participants would wait until they can precisely, or even broadly, quantify the *expected impact* of climate change to manage risk, it would likely be too late. Instead of managing expected impact, market participants manage their *risk*, which is the “what if”, not the “most likely.”

Managing Climate Risk

Based on the understanding of risk as a probabilistic function of the product of two metrics (i) sensitivity of a financial interest to climate change, and (ii) exposure of the financial interest to a climate change event or the likelihood of that event occurring, the Report suggests two methods for managing risk. One method is to decrease exposure, which can be done for example by reducing carbon output or ideally achieving carbon net-neutrality. The decrease in exposure will have the effect of reducing the overall risk. The second method is to decrease the net sensitivity

¹³⁴ Commodity Futures Trading Commission. 2020. “Managing Climate Risk in the U.S. Financial System”. <https://www.cftc.gov/sites/default/files/2020-09/9-9-20%20Report%20of%20the%20Subcommittee%20on%20Climate-Related%20Market%20Risk%20-%20Managing%20Climate%20Risk%20in%20the%20U.S.%20Financial%20System%20for%20posting.pdf>

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of the asset, which can be done via financial derivatives that hedge the asset's sensitivity. For example, a carbon offset future. That decrease in sensitivity will also reduce the overall risk.

Climate Risk/Political Control Risk Similarities

Even though the particular impacts of climate change are not known, and certainly the impacts to any market participant are not known, climate change nonetheless poses risk to market participants, and that risk can and should be hedged. This understanding of risk, and risk management, is equally important and applicable to political control. Like climate change, the precise impact of political control to a market participant is not known. Like climate change, political control nonetheless impacts risk. An asset or financial interest that is sensitive to policy or political change, such as climate change, has exposure to political control, as political control impacts the likelihood of a negative incident occurring. A derivative contract can be used to reduce the net sensitivity, and just like in the case of climate change risk, the reduced sensitivity will effectively reduce risk. The same risk management and climate risk hedging described in the Report applies to political control hedging using derivative contracts.

Characteristic	Climate Change Risk	Political Control Risk
Is a risk because it could lead to negative financial impact	✓	✓
Specific impacts unknown	✓	✓
Risk is the product of (i) potential impact of an event or events (sensitivity), and (ii) likelihood of the event occurring (exposure)	✓	✓
Derivatives can be used to reduce net <i>sensitivity</i> , which reduces overall risk	✓	✓

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APPENDIX M (CONFIDENTIAL) – ADDITIONAL MATERIALS

Letters by Kalshi’s counsel are provided in a separate document attached to this certification. Also attached is a copy of Commissioner Pham’s dissent on a vote favoring review of Kalshi’s original contract pursuant to the special rule.

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September 25, 2022

SUBMITTED VIA CFTC PORTAL

Secretary of the Commission

Office of the Secretariat

U.S. Commodity Futures Trading Commission

Three Lafayette Centre 1155 21st Street, N.W.

Washington, D.C. 20581

Re: Comments Responding to the Commission's Specific Questions Related to KalshiEX, LLC's Proposed Congressional Control Contracts

To Whom It May Concern:

KalshiEX, LLC ("Kalshi" or "Exchange") is grateful to the Commission for its consideration of Kalshi's proposed contracts. The Exchange welcomes the opportunity to address the Commission's questions. This comment addresses the first question and the third question that the Commission asked:

1. Do these contracts involve, relate to, or reference gaming as described in Commission regulation 40.11(a)(1) and section 5c(c)(5)(C) of the Commodity Exchange Act, or in the alternative, involve, relate to, or reference an activity that is similar to gaming
2. as described in regulation 40.11(a)(2) or section 5c(c)(5)(C) of the Commodity Exchange Act?
3. Do these contracts involve, relate to, or reference "an activity that is unlawful under any State or Federal law" as described in Commission regulation 40.11(a)(1) and section 5c(c)(5)(C) of the Commodity Exchange Act?

This comment is divided into two parts. Part 1 discusses the statute. In particular, Part 1 of the comment addresses section 5c(c)(5)(C) of the Commodity Exchange Act ("CEA"), codified¹ at 7 U.S.C. 7a-2(c)(5)(C).² Of particular importance, Part 1 is based on an analysis of the statute

¹ The CEA section designations do not align with the section designations in the United States Code. Because this is a public comment, the Exchange will generally use citations to the United States Code as opposed to the CEA, which will enhance the public's ability to research and analyze the issues presented.

² The Exchange will address the applicability of the regulations at 17 C.F.R. 40.11 in a separate comment, and also in the appendix to this comment in the Counsel Analyses. However, the Exchange notes here that the regulation cannot exceed the authority in the statute that the regulation implements. This is axiomatically true even under the *Chevron* deference from *Chevron, Inc. v. Natural Resources Defense Council*, 467 U.S. 837 (1984). Indeed, step one of *Chevron* is to determine whether Congress expressed intent in the statute and, if so, whether or not the statute's intent is ambiguous. It is black letter law that if the statute is clear, the regulating agency cannot regulate contrary to the statute. Indeed, earlier this year in *Empire Health*, Justice Kagan, writing for the Court, held that the government's regulation was valid only because the "regulation correctly construes the statutory language at issue." *Becerra v. Empire Health Foundation*, 142 S. Ct. 2354 (2022). Had that not been the case, Justice Kagan and the Court would have held the regulation invalid.

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irrespective of any rule, including 40.11, which the Commission has issued or may, in the future, promulgate to implement this statutory provision.

As a threshold matter, the Exchange notes that the majority of the Commission's questions for public comment assume that the Special Rule in CEA 5c(c)(5)(C) ("Special Rule") applies or can apply to Kalshi's political control contract ("Contract"), a question that the Commission invites the public to address in questions 1 and 3. If the answers to questions 1 and 3 are no, many of the other questions become moot, at least in regard to the Contract, which is the sole matter under Consideration in this Commission action.³

Part 2 includes analyses from Jonathan Marcus and Dan Davis that directly address Questions 1 and 3. Messrs. Marcus and Davis both served as General Counsel of the Commission prior to assuming their current positions in private practice.

Part 1

Contracts, events, and other important terms

There are several terms that are key to understanding the framework that Congress created for the Special Rule that appear throughout this comment and are helpful to define here:

- "Event Contract"
- The "Event Contract's Event" (also, referred to as the "contract's Event")
- The "contract, considered as a whole" (also, referred to as the "contract, as a whole", the "contract, itself", and the "contract itself, considered as a whole")

An "Event Contract" is a contract that is based on an occurrence, extent of an occurrence, or a contingency. For example, a contract whose terms and conditions specify that the holder of the contract will receive payment based on the occurrence of a hurricane is an Event Contract because it is based on an occurrence, a hurricane. The terms and conditions of Kalshi's Contract specify that holders of the contract will receive money based on the occurrence of political control over Congress.⁴ It is an event contract because it is based on an occurrence, political control.⁵

A contract's "Event" refers to the specific occurrence, extent of an occurrence, or contingency on which the contract is based. A hurricane contract's event is the hurricane. Kalshi's Contract's event is political control

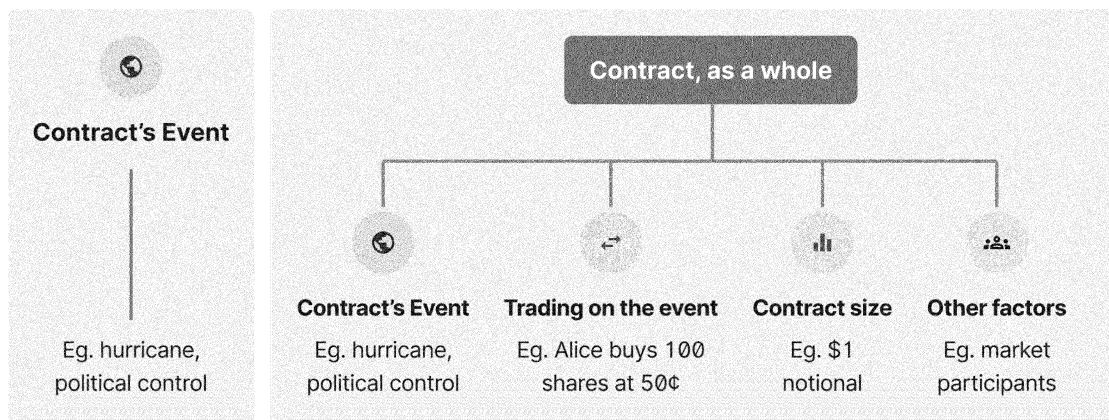
The phrase "contract, considered as a whole" refers to a broad view of a contract and all factors that surround or are a part of the contract. For example, this would include the activity of buying and selling the contract ie. the activity of *trading* the contract, the information embedded in the contract's pricing, and in the case of an Event Contract, the contract's Event.

Accordingly, any suggestion that the Commission's regulation 40.11, which implements the statute at 7 U.S.C. 7a-2(c)(5)(C), applies to a contract to which the statute itself does not apply is specious. If the regulation did, it would be invalid. Regardless, a careful reading of the regulation shows that the regulation does not apply to any contract to which the statute does not apply. We address the regulation in more depth in Part 2.

³ Specifically, if the answers to questions 1 and 3 are no, the following questions would be moot insofar as they would not apply to the Contract: 2, 4, 6, 7, 8, 9, 10, 11, 12, 13, 14, 17. Question 5, which assumes the soundness of the legal reasoning in the Nadex Order, *see infra*, would also be moot.

⁴ Please see the full filing for the full terms and conditions of the Contract.

⁵ Specifically, the contract is based on the party membership of the Speaker of the House and the President Pro Tempore.



The statute

Part 1 of this comment focuses on the correct interpretation of the Special Rule, which is set forth in a statute. The full text of the statute⁶ is included here, for the reader's convenience:

(C) Special rule for review and approval of event contracts and swaps contracts **(i) Event contracts**

In connection with the listing of agreements, contracts, transactions, or swaps in excluded commodities that are based upon the occurrence, extent of an occurrence, or contingency (other than a change in the price, rate, value, or levels of a commodity described in section 1a(2)(i) of this title), by a designated contract market or swap execution facility, the Commission may determine that such agreements, contracts, or transactions are contrary to the public interest if the agreements, contracts, or transactions involve-

- (I) activity that is unlawful under any Federal or State law;
- (II) terrorism;
- (III) assassination;
- (IV) war;
- (V) gaming; or
- (VI) other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.

(ii) Prohibition

No agreement, contract, or transaction determined by the Commission to be contrary to the public interest under clause (i) may be listed or made available for clearing or trading on or through a registered entity.

General background on the CEA's Special Rule

Under the CEA, contract listing is not a "permission" regime. Contracts do not need Commission approval to be listed, and although the CEA provides a mechanism that exchanges may utilize to put a contract before the Commission for approval, whether or not to utilize that method is solely

⁶ 7 U.S.C. 7A-2(c)(5)(C).

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in an exchange's discretion.⁷ Indeed, the overwhelmingly vast majority of contracts are never presented to the Commission for approval under this mechanism. Even in those rare instances when the Commission is formally presented with a contract for approval, the Commission's discretion over whether to grant or withhold approval is limited; under the statute and the regulations, the Commission must approve every contract that does not violate the CEA or the regulations.⁸ The Commission was not granted authority to conduct a "is this a contract that I am comfortable with" analysis and the Commission was not granted authority to disapprove a contract because it does not like it.⁹

The Commission was also not granted the authority to prohibit any contract on the grounds that it violates the public interest. There is one exception to this rule, where Congress did give the Commission the authority to prohibit a contract that the Commission determines is contrary to the public interest.¹⁰ This exception is the Special Rule in 5c(c)(5)(C) of the Commodity Exchange Act.¹¹ This Special Rule gives the Commission discretion to consider, for very specific types of contracts, whether a contract is contrary to the public interest.¹²

There are two aspects to the Special Rule. The first is the Special Rule's eligibility requirements; the Special Rule does not apply to all contracts. It only applies to a specifically defined subset of contracts, identified through a two-step process described below, that are eligible for the Special Rule. If a contract is determined to be eligible for the Special Rule, it is not automatically prohibited. The Special Rule only prohibits contracts that are eligible for the Special Rule if the Commission determines that the contract is contrary to the public interest. The second aspect of the Special Rule thus is determining whether the contract that is eligible for the Special Rule is contrary to the public interest. Congress laid out the process for the Special Rule in three steps.

The three steps of the Special Rule

There are three steps in the Special Rule.

Step one of the Special Rule ("Step One") is to determine if the contract is eligible for the Special Rule. The statute limits the scope of the Special Rule to contracts that are "based upon [an] occurrence, extent of an occurrence, or contingency" (collectively "Event"). In other words, to be eligible for the Special Rule, a contract must be based on an Event, *i.e.*, the contract must be an Event Contract. If a contract is not an Event Contract, it is not eligible for the Special Rule and the contract fails Step One. The analysis then terminates and the Special Rule does not apply to that contract. If the contract is an Event Contract, the analysis proceeds to step two.

Step two of the Special Rule ("Step Two") is to determine if the Event Contract's Event involves¹³ certain activities that were listed by Congress in the Special Rule. These activities are:

1. an activity that is unlawful under any Federal or State law;

⁷ This process is set forth in 17 C.F.R. 40.3, which the Commission titled "*Voluntary* submission of new products for Commission review and approval."

⁸ 7 U.S.C. 7a-2(c)(5)(B); 17 C.F.R. 40.3(b).

⁹ *Id.*

¹⁰ As explained below and in a second comment letter, even if, *arguendo*, the Special Rule applied to the Contract (which it does not), the Special Rule would still not prohibit the Contract because it is *in* the public interest, and therefore certainly not contrary to the public interest.

¹¹ 7 U.S.C. 7a-2(c)(5)(C).

¹² *Id.*

¹³ Please see *infra* the "A further look at step two of the Special Rule" for more discussion on the correct interpretation of step two and why step two is limited to the contract's Event.



2. terrorism;
3. assassination;
4. war;
5. gaming;

In addition to these five specific activities, Congress included a sixth activity: “other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.”¹⁴ This sixth activity gives the Commission discretion to identify other similar activities that are contrary to the public interest. If the Event Contract’s Event does not involve any of the six activities that are listed in the Special Rule, the Event Contract is not eligible for the Special Rule. The analysis terminates and the Special Rule does not apply to prohibit the contract. If the Event Contract’s Event does involve at least one of these activities, the analysis continues to step three.

Step three of the Special Rule (“Step Three”) is for the Commission to determine whether the contract itself, considered as a whole, is contrary to the public interest.¹⁵ If the Commission does not determine that the contract is contrary to the public interest, the contract is not prohibited under the Special Rule. If the Commission determines that the contract is contrary to the public interest, the Special Rule applies and the contract is prohibited.¹⁶

The three steps that the Commission follows in applying the Special Rule are therefore:

Step 1: Is the contract an Event Contract? If no, stop. If yes, continue to step 2.

Step 2: Does the Event Contract’s Event involve an activity that was included by Congress in the Special Rule? If no, stop. If yes, continue to step 3.

Step 3: Is the contract itself, considered as a whole, contrary to the public interest? If no, the contract is not prohibited. If yes, the contract is prohibited.

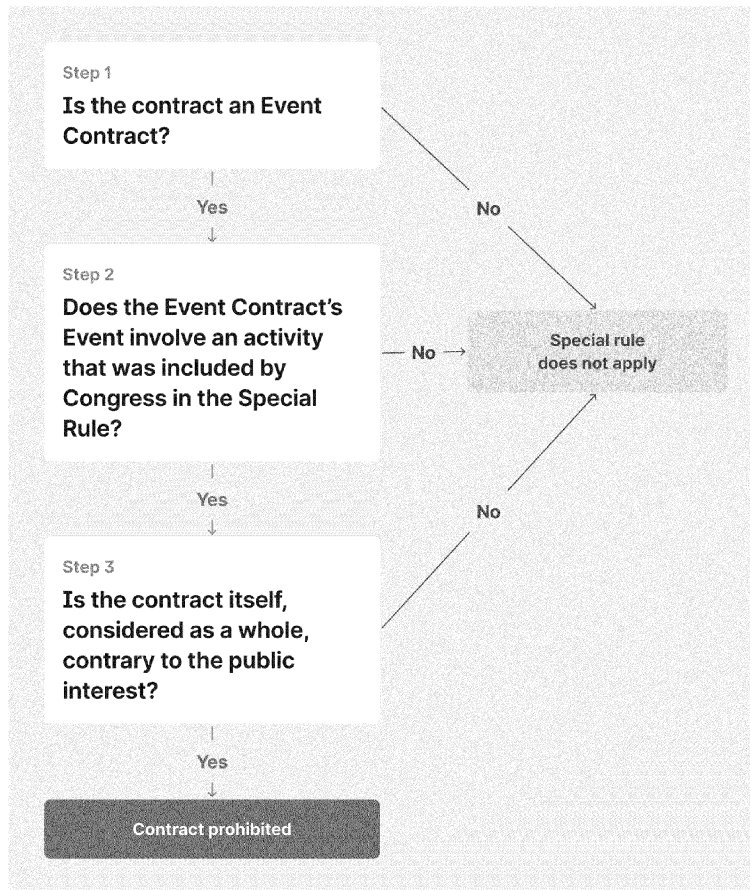
Graphically, the flow of the three steps looks like this:

¹⁴ 7 U.S.C. 7a-2(c)(5)(C)(i)(VI).

¹⁵ The phrase “contrary to the public interest” is used three times in the Special Rule. It is used in clause (i) in reference to the sixth activity in the list of activities Congress included in step two of the Special Rule. In this context, it is the *contract’s Event* that is contrary to the public interest, not the *contract itself*. It is also used in clause (i) in step three and in the prohibition in clause (ii) in reference to the *contract itself*.

¹⁶ 7 U.S.C. 7a-2(c)(5)(C)(ii). (“No agreement, contract, or transaction determined by the Commission to be contrary to the public interest under clause (i) may be listed or made available for clearing or trading on or through a registered entity.”)

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Step One and Step Two limit the scope of contracts to which the Special Rule applies. Step One limits the Special Rule only to Event Contracts. Step Two limits this scope further. Step Two provides that the Special Rule does not apply to *all* Event Contracts, but only to those contracts whose Events involve one of the activities Congress listed in the statute. Step Three provides that even a contract that passes Steps One and Two is not prohibited unless the Commission determines that the contract, considered as a whole, is contrary to the public interest. The following graphic illustrates how each step of the Special Rule functions to narrow the scope of the contracts that are prohibited under the Special Rule.

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All Contracts

Step 1 Is the contract an Event Contract?

Step 2 Does the Event Contract's Event involve an activity that was included by Congress in the Special Rule?

Step 3 Is the contract itself, considered as a whole, contrary to the public interest?

To further explain the role of Step Three, Congress did not prohibit an Event Contract whose Event involves an activity listed in the Special Rule.. It is possible that an Event Contract's Event involves an activity listed in the Special Rule but the Commission does not determine that the contract, considered as a whole, is contrary to the public interest. That contract would not be prohibited under the Special Rule. For example, an Event Contract on the invasion of Ukraine would satisfy Steps One and Two because it is an Event Contract (Step One) and the Event Contract's Event involves war, one of the activities that is listed in the Special Rule (Step Two). That does not mean that the contract is prohibited; it moves to step three for the Commission to determine if the Event Contract, considered as a whole, is contrary to the public interest. The Commission may determine that it is contrary to the public interest, in which case the Event Contract would be prohibited by the Special Rule.¹⁷ And the Commission may determine that it is not contrary to the public interest. As Commissioner Johnson recently noted, "Geopolitical events in Europe, specifically, the invasion of Ukraine has led to remarkable disruptions in energy and agriculture markets."¹⁸ Accordingly, the Commission may find that the Event Contract has hedging utility and/or other economic utility or benefits and thus could not determine that the Event Contract is contrary to the public interest. This point, that a contract's event can involve an activity listed in the statute and still be allowed because the contract itself is not contrary to the public interest was made by then-Commissioner Berkovitz in his statement on ErisX's RSBIX contracts.¹⁹

¹⁷ 7 U.S.C. 7a-2(c)(5)(C)(ii).

¹⁸ [Opening Statement of Commissioner Kristin N. Johnson before the Energy and Environmental Markets Advisory Committee | CFTC](#), September 20, 2022.

¹⁹ Commissioner Berkovitz's statement is available here:

<https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement040721>. Commissioner Berkovitz concluded his statement by noting that, "If sporting event contracts with an economic purpose, such as hedging, are allowed to be traded on a DCM, the general public must be able to access and trade those contracts on the exchange. The public cannot be barred from trading a contract listed on a DCM. However, gaming contracts without any economic purpose should not be permitted on a DCM."



A further look at step two of the Special Rule

Once an Event Contract passes Step One, the analysis moves to Step Two of the Special Rule. Step Two is to determine if the Event Contract involves an activity that was listed by Congress in the Special Rule. For the purposes of step two of the Special Rule, an Event Contract only involves an activity if the Event Contract’s *Event* involves that activity.²⁰ For example, an Event Contract can only involve war if the Event Contract’s Event involves war. Conversely, if the Event Contract’s Event does not involve war, then the Event Contract does not involve war. Similarly, an Event Contract will involve gaming only if the Event Contract’s Event involves gaming. For the purposes of Step Two, it is irrelevant if something else surrounding the Event Contract, such as the market activity of trading the contract, involves a listed activity. The only relevant factor for Step Two is whether the Event Contract’s Event involves the listed activity, not whether the Event Contract, considered as a whole, involves the listed activity.

There are many reasons why the analysis of whether an Event Contract involves a listed activity in Step Two is limited to the Event Contract’s Event, and does not include the consideration of the Event Contract as a whole. Many of these reasons are stated in the letters in Part 2 of this comment, as well as by other commenters.²¹ The Exchange provides two reasons here. (For convenience, this comment refers to the incorrect reading that the analysis under Step Two includes the Event Contract, considered as a whole, and is not limited to only the Event Contract’s Event, as the “Contract as a Whole view of Step Two”.)

The Contract as a Whole view of Step Two is wrong. An Event Contract cannot be considered to involve a listed activity based on the Event Contract considered as a whole, and not only the Event Contract’s Event. If step two were so broad, it would (1) defeat Congress’ intended narrowing function, and (2) render the statute internally inconsistent.

The sixth activity illustrates the flaw in applying Step Two broadly, ie. Contract as a whole View of Step Two. Congress included as the sixth activity a “similar activity [to the first five activities, that is] determined by the Commission, by rule or regulation, to be contrary to the public interest.” Under the Contract as a Whole view of Step Two, the sixth activity means that the Commission can determine that any factor that is part of an Event Contract is contrary to the public interest.²² For example, the Commission can determine that *trading* contracts on a certain event is a “similar activity” to the listed activities and is contrary to the public interest. These contracts would satisfy Step Two even though the Event contracts are based on Events that are *not* contrary to the public interest because the *trading* on the contract *is* contrary to the public interest per the Commission’s determination, and trading on the contract is part of the contract when considered as a whole.

The analysis would then move to Step Three. But Step Three calls for a public interest analysis

²⁰ The analysis of the Event Contract in Step Three is different from Step Two. The analysis in Step Three considers the Event Contract as a whole, and is not limited to the Event Contract’s Event. Conversely, the analysis in Step Two is limited to what activities the Event Contract’s Event involves.

²¹ See e.g. the comments of Josh Sterling, Timothy McDermott, Daniel Gorfine, Lewis Cohen, Jeremy Weinstein, and Railbird Technologies.

²² This is because under the Contract as a Whole view of Step Two, Step Two is not limited only to looking at the Event Contract’s Event. The analysis in Step Two looks at the Event Contract as a whole. Accordingly, the activities included in the list in Step Two are not confined to the Event Contracts’ Events, and can include anything related to the Event Contract.



of the Event Contract, considered as a whole, where it has already been determined under Step Two that the *trading itself* is contrary to the public interest, i.e. that the Event Contract, considered as a whole, is contrary to the public interest. This results in two consecutive steps that do the exact same thing:

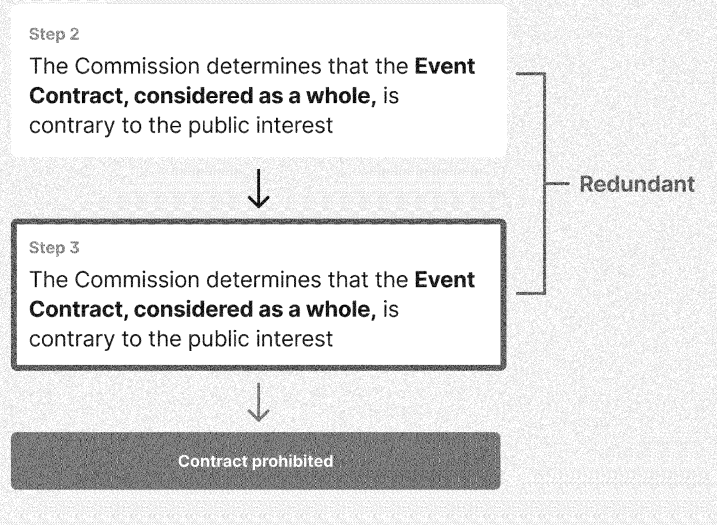
- Step Two: the Commission determines that the Event Contract, considered as a whole, is contrary to the public interest
- Step Three: the Commission determines that the Event Contract, considered as a whole, is contrary to the public interest (*again*)

This illustrates the fundamental flaw in the Contract as a Whole view of Step Two. What Congress clearly designed is a statute that allows the Commission to apply special scrutiny to contracts based on particular events that Congress identified as problematic. Congress did not shut the door to such contracts, but recognized that trading on an Event Contract whose Event is a problematic activity that involves, say, assassination or terrorism might nevertheless have redeeming features (such as hedging utility) that would justify the conclusion that the Event Contract, considered as a whole, is not contrary to the public interest. In this way, Congress clearly differentiated the Event Contract's Event (which may be disfavored), and trading in the Event Contract (permitted where trading on the disfavored activity offers economic and other societal benefits). When trading in the Event Contract *itself* is included in the analysis at Step Two, the distinction Congress sought to draw between the underlying event and trading in the contract is obliterated.²³

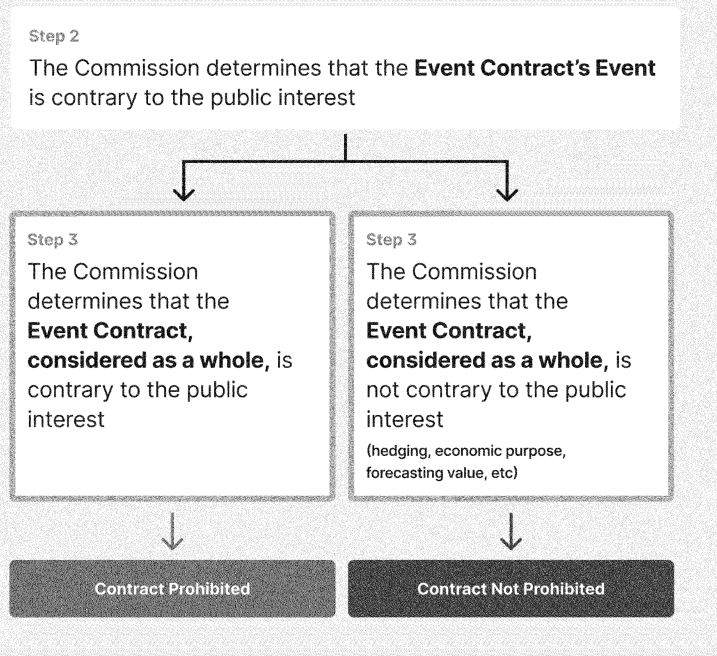
²³ This defect in the statute that emerges from the Contract as a Whole view of Step Two is from the sixth activity. The fact that the defect stems from the sixth activity does not mean that defect is limited to the sixth activity and that the Contract as a Whole View of Step Two is fine with regard to activities one through five. That would misapprehend the way that statutes work. Once it is demonstrated that step two cannot be about the contract, considered as a whole, for even one activity, that view is proven wrong. Therefore, the Contract as a Whole view of Step Two is an incorrect reading of the statute regardless of the activity.



The use of (c)(5)(C)(i)(VI) under the incorrect Contract as a Whole view of Step 2



The use of (c)(5)(C)(i)(VI) under the correct view of Step 2





Additionally, the Contract as a Whole view of Step Two actually renders all of the first five activities in Step Two superfluous. Once a contract passes Step Two, no matter which activity the contract involves, it must pass Step three to be prohibited by the Special Rule. The analysis in Step Three is for the Commission to determine whether the Event Contract, considered as a whole, is contrary to the public interest. *Any* Event Contract that the Commission determines is contrary to the public interest in step three *necessarily* would also satisfy the sixth activity in Step Two. For example, an Event Contract that involves war will pass Step Two. The analysis of the Event Contract will then move to Step Three, and assume that the Commission finds that the contract is contrary to the public interest. At that point, the Event Contract actually involves *two* of the listed activities: (i) it involves the activity of war, and (ii) it *also* involves an activity that the Commission has determined is contrary to the public interest. It is impossible for an Event Contract to pass Step Three and not involve the sixth activity in Step Two. Accordingly, there is no point in the first five activities listed in Step Two, only the sixth activity. In fact, there would be no point in Step Two at all. As noted, the sixth activity in Step Two and Step Three are identical. Accordingly, if the Contract as a Whole view of Step Two is correct, Congress would have just skipped Step Two altogether. The Special Rule would have been a simple six line statute that said only:

In connection with the listing of agreements, contracts, transactions, or swaps in excluded commodities that are based upon the occurrence, extent of an occurrence, or contingency (other than a change in the price, rate, value, or levels of a commodity described in section 1a(2)(i) of this title), by a designated contract market or swap execution facility, the Commission may determine that such agreements, contracts, or transactions are contrary to the public interest.

The inevitable collapse of all of the Step Two activities into the sixth activity and the collapse of the sixth activity into Step Three under this expansive interpretation of Step Two shows that the Contract as a Whole view of Step Two is wrong. The correct view of Step Two is that it, like Step One, simply describes what the contract is based on, and the analysis in Step Two is limited to the Event Contract's Event. Accordingly, there is a big difference between Step Two, including the sixth activity, and Step Three. Step Two is focused only on the Event Contract's Event. If an Event Contract passes Step Two because the Event Contract's Event involves any of the listed activities, even the sixth activity, the analysis under Step Two will always be different from the analysis under Step Three. The analysis under Step Two will be whether the Event Contract's Event involves the activity. The analysis under Step Three is very different. Step Three does not only consider the Event Contract's Event alone, it considers the Event Contract, considered as a whole. Thus, all of the anomalies that directly stem from the Contract as a Whole view of Step Two disappear under the view that the analysis in Step Two (like Step One) considers only the Event Contract's Event.

The correct reading of the statute is that the analysis in Step Two, like Step One, is limited to the Event Contract's Event. Steps One and Two work in concert to create the eligibility requirements for the *type* of contract that the Special Rule applies to (*i.e.*, an Event Contract whose Event involves a listed activity), and Step Three serves as an independent step whose analysis considers the Event Contract, as a whole. Together, all three steps form a coherent and cohesive statutory rule that implements Congress's intent to have the Commission review a narrow subset of event contracts whose underlying events involve activities (such as terrorism and assassination) Congress did not want to automatically legitimize via futures and swaps trading on them. Congress nevertheless gave the Commission discretion to allow such contracts to be listed if

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trading them would not be contrary to the public interest.

The Nadex Order's incorrect reading of the Special Rule

In the Commission's 2012 Nadex Order²⁴ ("*Nadex Order*") (see Question 5), the Commission applied the Special Rule to contracts on the occurrences of political control and the election of the President of the United States. These occurrences do not involve any of the activities in step two of the Special Rule. Despite this, the *Nadex Order* concluded that the Special Rule applied and prohibited the contracts. The *Nadex Order* adopted the Contract as a Whole view of Step Two, and assumed that the analysis in Step Two considers the Event Contract as a whole, not just the Event Contract's Event. The *Nadex Order* found that the election contracts involved the activity of gaming even though the contract's Event did not, because the act of trading on the contract was gaming and therefore, those contracts, considered as a whole, satisfied Step Two.

This Contract as a Whole view of Step Two that the *Nadex Order* adopted is wrong, and should be rejected. As discussed at length, it violates the structure and the framework of the statute, and it leads to absurd results. The correct view of the statute is that Step Two, like Step One, relates to what the contract is based on, or the contract's Event.

The Nadex Order's misreading of the statute would apply to every futures and swap contract on an occurrence

The consequence of the Contract as a Whole view of Step Two that the *Nadex Order* adopted is that the Special Rule applies to *all* futures, commodity options, and swap contracts that are based on an occurrence, extent of an occurrence, or a contingency. The *Nadex Order* found that the contracts at issue there were gaming because the act of trading the contracts would fit within state law and federal law definitions of gaming. That same reasoning would apply to *all* futures, commodity options, and swaps that are based on an occurrence, extent of an occurrence, or contingency, because the act of trading these contracts would also fit within definitions of gaming. For example, the *Nadex Order* cited the law in North Dakota that "'Gambling' means risking any money ... upon ... the happening or outcome of an event, including an election ... over which the person taking the risk has no control."²⁵ The *Nadex Order* also cited the New Hampshire law that "'Wager' means a monetary agreement between 2 or more persons that a sum of money ... shall be paid to one of them on the happening or not happening of an uncertain event."²⁶

The approach the Commission adopted in the *Nadex Order* expands the scope of the Special Rule far beyond what Congress intended. Under the *Nadex Order* and in light of the breadth of some definitions of gaming activity, the Commission could deem the staking of value on any type of future event gaming. Alternatively, the Commission could determine via the authority granted in the Sixth Activity, that trading on any type of future event is similar to the other enumerated activities. The vast breadth of such discretion cannot be squared with the specific enumeration of activities, which Congress clearly designed to cabin the Special Rule's scope.

²⁴ CFTC Order Prohibiting North American Derivatives Exchange's Political Event Derivatives Contracts" (Apr. 2, 2012) available here: [CFTC Issues Order Prohibiting North American Derivatives Exchange's Political Event Derivatives Contracts | CFTC](#).

²⁵ *Nadex Order* fn. 1

²⁶ It is true that the *Nadex Order* also cited state laws that were more tailored to elections specifically, but that does not negate the point that there are also state laws that define gaming broadly that would include trading any futures, commodity options, or swap contracts that pass step one. Picking and choosing which state statutes to consider informative in a manner that is expedient for a desired outcome is not the proper way for the Commission to adopt its definitional framework.



This reality illustrates the *Nadex Order's* flaw in going beyond the event underlying the contract -- elections -- to determine whether the contract was gaming.

This argument is addressed in greater detail in Part 2 of this comment. However, the Exchange notes here that this overbreadth is a problem exclusive to the approach to the Contract as a Whole view of Step Two adopted in the *Nadex Order*. Under the more tailored approach where step two of the Special Rule is limited to the contract's Event, this overbreadth disappears..

Applying the three steps of the Special Rule to Kalshi's Contract

Applying the three steps to Kalshi's contract shows that the contract is not subject to the Special Rule.

Kalshi's Contract passes Step One. It is a contract based on the occurrence of political control. The Contract is an Event Contract, meeting the eligibility requirements in Step One, and the analysis proceeds to Step Two.

Step Two is whether the Event Contract's Event involves an activity that was listed in Step Two. The Contract's Event is political control, specifically the dual occurrences of the party membership of the Speaker of the House and the President Pro Tempore. These do not involve any of the listed activities.

- The occurrence of political control does not involve activity that is illegal under either Federal or State Law.
- The occurrence of political control does not involve the activity of terrorism.
- The occurrence of political control does not involve the activity of assassinations.
- The occurrence of political control does not involve the activity of war.
- The occurrence of political control does not involve the activity of gaming.²⁷
- The occurrence of political control does not involve an activity that the Commission has determined to be contrary to the public interest.

The Contract's Event, therefore, does not involve an activity that was included by Congress in the list of activities in Step Two of the Special Rule, and therefore the contract fails the Step Two eligibility requirements. The analysis therefore terminates and does not proceed to Step Three, and Congress did not authorize the Commission to apply the Special Rule to prohibit the Contract.

Conclusion to Part 1

Congress granted the Commission in the Special Rule the authority to prohibit certain contracts. This grant of authority is subject to the rules that Congress created. Congress included three distinct steps to determine if a contract is prohibited under the Special Rule. The Commission must abide by these rules. Step Two is clear; the analysis only considers whether the Event Contract's Event involves a listed activity, and it does not consider the Event Contract, as a whole. The Kalshi Contract's Event is political control. Political control does not involve any of the activities that Congress included in Step Two. Accordingly, the Contract fails Step Two, and the Special Rule cannot prohibit the Contract.

²⁷ The Commission has never stated, or even implied, that the occurrence of elections involves gaming. In the Commission's Nadex order, the Commission stated that "*taking a position* in a Political Event Contract" is gaming because elections are a "a contest between electoral candidates." See *North American Derivatives Exchange, April 2, 2012 (cftc.gov)*, pg. 3. However, the Commission was careful to not suggest that elections themselves, the very bedrock and foundation of our democracy, are a game.



As required by the CEA in 7 U.S.C. 7a-2(c)(5)(B), the Commission should approve the Contract.

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Part 2

The following two letters contain analyses on the Special Rule, as well as the implementing regulations at 17 C.F.R. 40.11. They were originally submitted to the Commission for consideration as part of the original 40.3 submission, and the Exchange includes them now in a public comment for the Commission's further consideration.

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September 21, 2022

Sebastian Pujol Schott
Acting Deputy Director, Product Review Branch
Division of Market Oversight
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Non-Application of Event Contracts Provisions to KalshiEX LLC's Political Control Contracts

Dear Mr. Pujol Schott:

I write to you on behalf of KalshiEX LLC (“Kalshi”) with respect to its intention to self-certify certain political control contracts (the “Contracts”) to be listed for trading on its designated contract market (“DCM”), and to address any outstanding concerns the Commodity Futures Trading Commission (“CFTC” or “Commission”), including the Division of Market Oversight (“DMO”), might have. We greatly appreciate the Commission’s and DMO’s continued willingness to allow Kalshi to highlight the many reasons why the Contracts should be listed, including the demonstrated economic purposes they serve.

In the spirit of building upon that productive dialogue, and in advance of Kalshi’s self-certification of the Contracts, we wanted to elaborate on why Section 5c(c)(5)(C) of the Commodity Exchange Act (“CEA”) and CFTC Regulation 40.11 (together, the “Event Contracts Provisions”) do not provide a legal basis for the staff or the Commission to impede self-certification of the Contracts.

As further explained below, Section 5c(c)(5)(C)(i) of the CEA does not hinder self-certification of the Contracts because the activity on which they are based does not “involve” any of the enumerated event categories in the provision. Although the Commission previously determined

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RICHMOND ♦ SAN FRANCISCO ♦ SHANGHAI ♦ SILICON VALLEY ♦ SINGAPORE ♦ TYSONS ♦ WASHINGTON, D.C. ♦ WILMINGTON

Sebastian Pujol Schott
 September 21, 2022
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that other political event contracts that were self-certified by a different exchange, the North American Derivatives Exchange (“Nadex”), were subject to the Event Contracts Provisions, that determination was based on a misinterpretation of the Event Contracts Provisions. Therefore, the Commission’s previous determination on Nadex’s proposed contracts should not be followed here with regards to the Contracts.¹ Under the Event Contracts Provisions, and contrary to the Commission’s order relating to Nadex’s political event contracts (“Nadex Order”), which determined that the *trading* of contracts based on the outcomes of elections constituted gaming activity, the Commission must consider whether the occurrence or contingency *on which the Contracts are based* – elections – involves one of the enumerated activities. And because elections do not fit within any of the enumerated event categories, the Event Contracts Provisions provide no basis to delay self-certification. CFTC Regulation 40.11 calls for the same result. Accordingly, even if, arguendo, CFTC Regulation 40.11 contains language that could be construed to support a different result, the Commission should read CFTC Regulation 40.11 to be consistent with Section 5c(c)(5)(C) and, accordingly, the Contracts should be self-certified without delay or encumbrance.

As explained in greater detail below, because the Event Contracts Provisions do not establish any legal or regulatory basis for impeding the Contracts, the Commission should take no action that would delay Kalshi from self-certifying them pursuant to CFTC Regulation 40.2.

I. SECTION 5c(C)(5)(C) OF THE CEA PROVIDES NO BASIS TO IMPEDE SELF-CERTIFICATION OF KALSHI’S POLITICAL CONTROL CONTRACTS.

Section 5c(c)(5)(C)(i) of the CEA establishes that, in connection with the listing of agreements, contracts, or transactions on “excluded commodities that are based upon the occurrence, extent of an occurrence, or contingency[.]”

the Commission may determine that such agreements, contracts, or transactions are contrary to the public interest if the agreements, contracts, or transactions involve[:] (I) activity that is unlawful under any Federal or State law; (II) terrorism; (III) assassination; (IV) war; (V) gaming; or (VI) other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.

Section 5c(c)(5)(C)(ii) further specifies that “[n]o agreement, contract, or transaction determined by the Commission to be contrary to the public interest under clause (i) may be listed or made available for clearing or trading on or through a registered entity.” Thus, the CEA, through this

¹ In the Matter of the Self-Certification by North American Derivatives Exchange, Inc. of Political Event Derivatives Contracts and Related Rule Amendments under Part 40 of the Regulations of the Commodity Futures Trading Commission (April 2, 2012), available at: <https://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/if-docs/nadexorder040212.pdf>.

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provision, establishes a clear framework under which the Commission can – but is not obligated to – review an event contract that is based upon an “occurrence, extent of an occurrence, or contingency” that involves one of the enumerated underlying activities in order to determine if those contracts would be contrary to the public interest. A Commission determination that the contract is contrary to the public interest would render its listing prohibited.

In short, through Section 5c(c)(5)(C), Congress granted the Commission the discretion to determine that a given event contract is contrary to the public interest, and thereby prohibited, only when the event underlying that contract involves one of the statute’s specifically enumerated activities. Congress did not grant the Commission the authority to prohibit a contract based upon an event that involves an unenumerated activity on the grounds that it would be contrary to the public interest.²

The plain language and structure of Section 5c(c)(5)(C)(i) make clear that the scope of the Commission’s discretionary review is narrowly focused on the nature of the contract’s underlying event, not of trading in the contract itself. Section 5c(c)(5)(C)(i) begins with the clause: “[i]n connection with the listing of agreements, contracts, transactions, or swaps in excluded commodities *that are based upon the occurrence, extent of an occurrence, or contingency[.]*” (emphasis added). Thus, at the outset of the controlling provision, the statute establishes that the distinguishing feature of the contract is the nature of the occurrence or contingency. The final clause of Section 5c(c)(5)(C)(i), immediately prior to the provision’s enumeration of the covered activities, refers back to the first clause of the provision when it says: “the Commission may determine that *such* agreements, contracts, or transactions are contrary to the public interest if the agreements, contracts, or transactions involve” the enumerated activities. (emphasis added). When the clauses are read together, Section 5c(c)(5)(C)(i) grants the Commission only limited authority to review a contract that is “based upon [an] occurrence, extent of an occurrence, or contingency” that “involve[s]” one of the enumerated activities.

The plain language of the enumerated events themselves bolsters this interpretation. As Kalshi has pointed out in previous submissions,³ Section 5c(c)(5)(C)(i)’s first and sixth categories are defined respectively as an “*activity* that is unlawful under any Federal or State law” and “other similar *activity* determined by the Commission, by rule or regulation, to be contrary to the public interest.” (emphasis added). The inclusion of the noun “activity” (and the reference in the sixth

² This lack of authority includes the sixth enumerated activity (“other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest”), as that provision requires the Commission to conduct a rulemaking to determine that another activity is contrary to the public interest and then only if it is similar to one of the other specified underlying activities (crimes, terrorism, assassination, war, or gaming). See Commission Rulemaking Explained, available at: https://www.cftc.gov/LawRegulation/CommissionRule-makingExplained/index.htm#_ftn1.

³ Memorandum in Support of Kalshi’s Political Control Contracts, submitted to DMO March 28, 2022.

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category to all five preceding “similar activit[ies]”) makes clear that Congress intended the underlying activity, not the contract itself, to be the subject of review and scrutiny and it must be assumed that decision was intentional.⁴

The sixth enumerated activity (“other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest”), further highlights that Congress’s intention was for the Commission to analyze the activity underlying the contract rather than trading in the contract itself. This final enumerated activity provides the Commission a sort of catchall to determine whether the event involves “similar activity” to the preceding categories and thus might be inappropriate for listing. Since terrorism, assassination, war, and activity unlawful under state or federal law unquestionably refer to the occurrence or contingency underlying the contract, the sixth catch-all category must be read consistently with the rest of the enumerated list (apples must be compared to apples).⁵

Another reason that Section 5c(c)(5)(C) must be read as focusing on the underlying activity is that such focus is congruent with the nature of event contracts themselves. If Congress was concerned about trading in the contract itself, there is no indication why it would have limited the provision to event contracts rather than establishing a general rule that would have authorized the Commission to prohibit any derivatives contract that the trading in is, for example, unlawful under state law.

In the Nadex Order,⁶ the Commission did not interpret Section 5c(c)(5)(C) as focusing on the underlying activity. Instead, the Commission appears to have read the gaming provision (the fifth enumerated activity) to refer to trading in the contract itself. Accordingly, the Commission determined that the gaming provision applied to Nadex’s political event contracts because the contracts involved “a person staking something of value upon a contest of others.”⁷ The Commission likened this trading activity to activity prohibited by state anti-gambling laws. The Commission’s interpretation in this instance ran counter to the plain language and structure of the statute, as explained above.

⁴ The scant legislative history – a colloquy between Senators Diane Feinstein and Blanche Lincoln during the Senate’s consideration of Dodd-Frank’s regulation of event contracts – does not change the analysis. The colloquy did not address whether the underlying event, rather than trading in the contract itself, is the proper subject of analysis; instead, the Senators discussed the distinction in economic purpose between contracts that serve hedging utility and contracts that are designed predominantly for speculation. *See* 56 Cong. Rec. S5906-07 (July 15, 2010) (statements of Sen. Diane Feinstein and Sen. Blanche Lincoln), available at: <https://www.congress.gov/111/crec/2010/07/15/CREC-2010-07-15-senate.pdf>. In any event, the language and structure of the statute are clear, so resorting to legislative history is unnecessary.

⁵ We explain below why, notwithstanding the Commission’s Nadex Order, the gaming provision must also refer to the underlying activity and not trading in the contract itself.

⁶ *See supra* note 1.

⁷ Nadex Order at 3 (internal quotation marks omitted).

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Other principles of statutory construction also undercut the application of the Event Contracts Provisions in the Nadex Order. Under the Commission’s interpretation, a person trading a political event contract is engaged in gaming – “staking something of value upon a contest of others.”⁸ By parallel reasoning, a person trading a terrorism contract is engaged in terrorism and a person trading a war contract is engaged in war. That is not a tenable interpretation of the statute. If Congress intended the Commission to focus on the underlying event for some of the enumerated categories, but to focus on trading in the contract itself for others, it would have said so. It certainly cannot be presumed or inferred from silence that Congress intended the Commission to apply disparate analytical approaches to the single list of enumerated activities. When the correct interpretation of Section 5c(c)(5)(C) is applied to the Contracts, the result is clear. Elections are not illegal under state or federal law, are not gaming, and are not similar to any of the enumerated activities – federal or state crimes, terrorism, assassination, war, and gaming – all of which are activities that Congress did not want to legitimize or encourage via event contracts without careful consideration by the Commission. The Commission should therefore not impede Kalshi from self-certifying the Contracts and lacks a legal basis to invoke Section 5c(c)(5)(C) to do so.

While we could stop here, we believe it is worth pointing out that the Nadex Order not only contravenes the language and structure of Section 5c(c)(5)(C), but also threatens to upend the CEA itself. Virtually every futures or swaps contract can be described as staking something of value on the outcome of some future event.⁹ Yet the CFTC’s exclusive jurisdiction over derivatives markets means that the CEA preempts any state law that would attempt to regulate derivatives markets.¹⁰ Therefore, regulated futures and swaps contracts *cannot be* illegal gambling under state law.

In fact, many states ban “gambling” not just on elections, but more generally on the outcomes of future events. These laws would prohibit the entire category of event contracts (at a minimum), which both Congress and the CFTC have expressly permitted to be listed on DCMs. Some of these states provide carve-outs for CFTC-regulated products, or otherwise for activities like commodities and securities trading. However, not all do. New Hampshire, for example, bans gambling and defines it as, “to risk something of value upon a future contingent event not under one’s control or influence.”¹¹ Alaska also bans gambling and defines it similarly as when:

⁸ *Id.*

⁹ This overly broad interpretation of the term “gaming” would threaten to render 5c(c)(5)(C)’s other enumerated provisions superfluous, given that, as explained above, virtually all event contracts could potentially qualify for that categorization. As the Supreme Court has repeatedly observed, there is a “canon against interpreting any statutory provision in a manner that would render another provision superfluous.” *Bilski v. Kappos*, 561 U.S. 593, 607-8 (2010).

¹⁰ See *Am. Agric. Movement v. Bd. of Trade*, 977 F.2d 1147, 1156-57 (7th Cir. 1992) (holding that “When application of state law would directly affect trading on or the operation of a futures market, it would stand ‘as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress,’ and hence is preempted.” (quoting *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941))).

¹¹ NH Rev Stat § 647:2(II)(d), available at: <https://www.gencourt.state.nh.us/rsa/html/lxii/647/647-2.htm/>.

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...a person stakes or risks something of value upon the outcome of a contest of chance or a future contingent event not under the person's control or influence, upon an agreement or understanding that that person or someone else will receive something of value in the event of a certain outcome.¹²

Finally, at least one federal law that addresses gambling specifically carves out regulated derivatives products from their definitions of “bet or wager,” highlighting that Congress views the two types of transactions as fundamentally distinct. The Unlawful Internet Gambling Enforcement Act of 2006’s (“UIGEA”) definition of “bet or wager” specifically “does not include [as relevant here:]”

- (ii) any transaction conducted on or subject to the rules of a registered entity or exempt board of trade under the Commodity Exchange Act;
- (iii) any over-the-counter derivative instrument;
- (iv) any other transaction that—
 - (I) is excluded or exempt from regulation under the Commodity Exchange Act; or
 - (II) is exempt from State gaming or bucket shop laws under section 12(e) of the Commodity Exchange Act or section 28(a) of the Securities Exchange Act of 1934.¹³

Notably, the Commission relied upon UIGEA’s definition of “bet or wager” in its Nadex Order,¹⁴ but made no mention of the carve out for derivatives products.

All of these various provisions illustrate the flaw in evaluating whether *trading* a futures or swaps contract constitutes gaming or gambling activity, as the Commission did in the Nadex Order, or whether *trading* a futures or swaps contract is unlawful under federal or state law. Instead, to maintain the structural integrity of Section 5c(c)(5)(C) and the CEA itself, the Commission should evaluate whether the Contracts involve an underlying activity – elections – that fits into one of the enumerated categories of activities in Section 5c(c)(5)(C). Because elections do not

¹² AK Stat § 11.66.280(2).

¹³ 31 U.S.C. § 5362(1)(E) (2006).

¹⁴ *Supra* note 1 at 3.

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fit within any of the enumerated activities, the Commission should not impede self-certification of the Contracts.

II. CFTC REGULATION 40.11 CALLS FOR THE SAME RESULT.

A determination that Section 5c(c)(5)(C) does not present an obstacle to Kalshi’s self-certification of the Contracts should be dispositive, because CFTC Regulation 40.11, which the CFTC adopted to implement Section 5c(c)(5)(C), should likewise be read to allow only for the Commission’s consideration of the contract’s underlying activity, rather than its consideration of trading in the contract itself. While the language of the rule is not identical to the statute, there is no reason to read the language of CFTC Regulation 40.11 to require an analysis of trading in the contract rather than the contract’s underlying activity that constitutes the event.

The scope of CFTC Regulation 40.11 should not be read to go beyond the scope of the special rule in the statute. By using the words “relates to, or references” in addition to “involves,” the regulation only reinforces that the relevant activity is the underlying event, not trading on the underlying event. It would not make sense for a futures contract or swap to “reference” trading in the contract; to the contrary, the word “reference” is a clear direction to focus on the underlying event that the contract “references.” Thus, under the regulation, like the statute, the relevant activity for purposes of the Commission’s event contract analysis is the activity on which the contract is based (or to which the contract refers) rather than the contract itself.¹⁵ Even if the different words in the regulation could conceivably be read to support a different analysis that would broaden the scope of contracts subject to the statute, courts have held that, even under a standard of review that is highly deferential, an agency interpretation will not stand if “it is contrary to clear congressional intent or frustrates the policy Congress sought to implement.”¹⁶

¹⁵ Because the Contracts are not based on an enumerated activity, the Commission does not need to consider undertaking a public interest analysis. If the Commission were to conclude otherwise, however, the Commission could either permit the contracts to be listed (the statute authorizes prohibition only upon a Commission determination that the contract would be contrary to the public interest, a determination that the Commission “may” undertake) or conduct a public interest analysis. CFTC Regulation 40.11 should not be read to constitute a blanket prohibition, as that reading could not be squared with the statute. *See* Statement of Commissioner Dan M. Berkovitz Related to Review of ErisX Certification of NFL Futures Contracts, available at: <https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitz-statement040721> (“if sports event contracts involving gaming are found to have an economic purpose, they should be permitted to be listed on a DCM and retail customers cannot be prohibited from trading those contracts”); Statement of Commissioner Brian D. Quintenz on ErisX RSBIX NFL Contracts and Certain Event Contracts, available at: <https://www.cftc.gov/PressRoom/SpeechesTestimony/quintenzstatement032521> (“Congress [through Section 5c(c)(5)(C) of the CEA] unambiguously provided a default rule that all event contracts, including the enumerated ones, are allowed”).

¹⁶ *Garcia Carias v. Holder*, 697 F.3d 257, 271 (5th Cir. 2012); *CHW W. Bay v. Thompson*, 246 F.3d 1218, 1223 (9th Cir. 2001) (“deference is not owed to an agency decision if it construes a statute in a way that is contrary to congressional intent or frustrates congressional policy”).

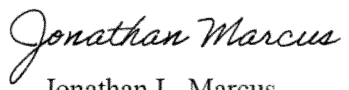
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III. CONCLUSION

For all of the reasons stated above, the Commission has no reason to stay Kalshi's self-certification of the Contracts. We welcome your feedback on this position and would appreciate the opportunity to follow-up on these specific considerations in a conference call or in-person meeting to the extent you have further questions.

Very truly yours,



Jonathan L. Marcus

Cc: Eliezer Mishory
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May 31, 2022

Elie Mishory
KalshiEx LLC
594 Broadway
New York, NY 10012

Re: Political Event Contracts, Section 5c(c)(5)(C) of the CEA, and CFTC Rule 40.11

Dear Mr. Mishory:

This letter is in response to your request for legal advice regarding KalshiEx LLC's ("Kalshi") engagement with the Commodity Futures Trading Commission ("CFTC" or "Commission") about the listing of certain event contracts relating to the partisan makeup of Congress, specifically the political control of Congress. One of the factors that Kalshi considers in listing contracts is ensuring regulatory compliance and, as such, you requested advice on the following question:

Are Kalshi's proposed political control contracts subject to the Commodity Exchange Act's ("CEA's") special rule for event contracts described in Section 5c(c)(5)(C) of the CEA and the implementing regulations at 17 C.F.R. § 40.11?

By way of background, in 2012, Nadex listed similar contracts (although with different characteristics) which the Commission prohibited by order ("Nadex Order"),¹ finding that trading in the Nadex contracts violated the CEA. Specifically, the Nadex Order found that Section 5c(c)(5)(C) of the CEA applied to the Nadex contracts because the Nadex contracts constituted gaming.² The Nadex Order also determined that the Nadex contracts were contrary to the public interest because the Nadex contracts could have an adverse effect on the integrity of elections.³

Section 5c(c)(5)(C) and Rule 40.11, however, are limited to only the underlying activity (not participating in the contract itself) and, because Kalshi's political control contracts do not match

¹ In the Matter of the Self-Certification by North American Derivatives Exchange, Inc. of Political Event Derivatives Contracts and Related Rule Amendments under Part 40 of the Regulations of the Commodity Futures Trading Commission (Apr. 2, 2012) (<https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/-documents/ifdocs/nadexorder040212.pdf>) (last visited May 30, 2022).

² Nadex Order at 2-3.

³ *Id.* at 4.

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any of the enumerated activities which the statute is expressly limited to, those contracts are not subject to the statute and implementing regulation. In reaching this conclusion, I will first provide some background of principles of interpretation and the relevant text of Section 5c(c)(5)(C) and Rule 40.11. I will then apply those principles to the Kalshi political control contracts and describe how the Nadex Order's conclusions to the contrary are incorrect.

I. BACKGROUND

A. Principles of Interpretation

Since the Nadex Order, the Supreme Court has significantly modified the method through which regulatory text should be interpreted and the circumstances in which an agency will receive deference for its interpretation of regulatory text. The tools for interpreting regulatory text are similar to those for evaluating statutory text. I first discuss these principles and then use them to evaluate Section 5c(c)(5)(C) and CFTC Rule 40.11 and their application to Kalshi's political event contracts.

The Supreme Court revamped the process for evaluating regulatory text in the 2019 case of *Kisor v. Wilkie*.⁴ In *Kisor*, the court considered whether to overrule *Auer v. Robbins*⁵ and *Bowles v. Seminole Rock*,⁶ cases which found that an agency was entitled to deference of its interpretation of an agency rule so long as it was not "plainly erroneous or inconsistent with the regulation."⁷ In *Kisor*, the Court did not overrule *Auer* and *Seminole Rock*, but significantly limited their application: "The deference doctrine we describe is potent in its place, but cabined in its scope."⁸

In reviewing the meaning of Rule 40.11, according to *Kisor*, one must "exhaust the 'traditional tools' of statutory construction."⁹ "Agency regulations can sometimes make the eyes glaze over. But hard interpretive conundrums, even relating to complex rules, can often be solved."¹⁰ One must "resort[] to all the standard tools of interpretation,"¹¹ including a careful consideration of

⁴ 139 S. Ct. 2400 (2019).

⁵ 519 U.S. 452 (1996).

⁶ 325 U.S. 410 (1945).

⁷ *Seminole Rock*, 325 U.S. at 414.

⁸ *Kisor*, 139 S. Ct. at 2408.

⁹ *Id.* at 2415 (quoting *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843, n. 9 (1984)).

¹⁰ *Kisor*, 139 S. Ct. at 2415.

¹¹ *Id.* at 2414.

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“the text, structure, history, and purpose of a regulation”¹² to determine whether a rule has “one reasonable construction of a regulation”¹³ or can “at least establish the outer bounds of reasonable interpretation.”¹⁴ In discussing this approach to regulatory construction, the Supreme Court relied heavily on the principles of statutory construction discussed in *Chevron* and its progeny.

B. The Statute And The Rule

With these key principles in mind, I turn to the statute and rule. This analysis begins, of course, with the statutory text of Section 5c(c)(5)(C) of the CEA, from which the CFTC promulgated Rule 40.11. That section of the CEA states:

In connection with the listing of agreements, contracts, transactions, or swaps in excluded commodities that are based upon **the occurrence, extent of an occurrence, or contingency** (other than a change in the price, rate, value, or levels of a commodity described in section 1a(2)(i) [2] of this title), by a designated contract market or swap execution facility, the Commission **may determine** that such agreements, contracts, or transactions are contrary to the public interest **if** the agreements, contracts, or transactions **involve—**

- (I) **activity** that is unlawful under any Federal or State law;
- (II) terrorism;
- (III) assassination;
- (IV) war;
- (V) gaming; or
- (VI) **other similar activity** determined by the Commission, by rule or regulation, to be contrary to the public interest.¹⁵

In relevant part for purposes of this analysis, Rule 40.11(a) states:

A registered entity shall not list for trading or accept for clearing on or through the registered entity any of the following:

- (1) An agreement, contract, transaction, or swap based upon an excluded commodity, as defined in Section 1a(19)(iv) of the Act, that **involves, relates to,**

¹² *Id.* at 2415.

¹³ *Id.*

¹⁴ *Id.* at 2416. The *Kisor* court goes on to explain that an agency’s interpretation of an ambiguous regulation may still not receive deference. The Court must then determine if “the character and context of the agency interpretation entitles it to controlling weight.” *Id.*

¹⁵ 7 U.S.C. § 7a-2(c)(5)(C)(i)(I)-(VI) (emphases added). If the Commission determines that such an agreement, contract, or transaction is contrary to the public interest, such agreement, contract, or transaction may not “be listed or made available for clearing or trading on or through a registered entity.” *Id.* § 7a-2(c)(5)(C)(ii).

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or references terrorism, assassination, war, gaming, or an **activity** that is unlawful under any State or Federal law; or

(2) An agreement, contract, transaction, or swap based upon an excluded commodity, as defined in Section 1a(19)(iv) of the Act, which involves, relates to, or references **an activity that is similar to an activity** enumerated in § 40.11(a)(1) of this part, and that the Commission determines, by rule or regulation, to be contrary to the public interest.¹⁶

II. APPLICATION TO KALSHI'S POLITICAL CONTROL CONTRACTS

To help frame the matter, the key question here requires understanding the limitations on the scope of Section 5c(c)(5)(C) and Rule 40.11. Is the scope (1) limited to contracts when the activity underlying the event contract involves one of the enumerated activities or do they (2) include the act of participating in the contract is itself?

Applying the principles of statutory and regulatory construction shows that Section 5c(c)(5)(C) and Rule 40.11 are limited to only the underlying activity (not participating in the contract itself) and, because Kalshi's political control contracts do not match any of the enumerated activities which the statute is expressly limited to, those contracts are not subject to the statute and implementing regulation.

A. Section 5c(c)(5)(C) and Rule 40.11 Apply Only To Event Contracts Where The Activity Underlying The Event Contract Is One Of The Enumerated Activities.

The plain text of Section 5c(c)(5)(C) demonstrates that Congress limited the statute's scope to instances where the underlying activity of an event contract is one of the enumerated events. If the activity underlying the event contract does not involve one of the enumerated activities, the listing is outside the scope of the Statute and Rule 40.11, regardless of how the act of *participating* in the event contract itself is classified. An interpretation of the statute that extends the applicable scope to also include contracts where the underlying activity is not one of the enumerated events is overbroad and incorrect.

First, Section 5c(c)(5)(C) limits the scope of the Commission's authority to "activities" and activities only. The Commission only has discretion to take action on (1) an "activity" that is unlawful under federal or state law; (2) one of four specifically listed "activities" (terrorism, assassination, war, or gaming); or (3) other similar "activity" determined by the Commission to be contrary to the public interest. The Commission itself has previously acknowledged that Section 5c(c)(5)(C)'s textual focus is on "activities," *i.e.*, the underlying conduct. In describing Section

¹⁶ 17 C.F.R. § 40.11(a) (emphases added).

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5c(c)(5)(C), the Commission stated that the rule applied to contracts that “involve one or more *activities* enumerated in the Dodd-Frank Act.”¹⁷ These “activities” are not the contracts themselves. They are the events that create the basis for the relevant contract.

To give but one straightforward example, in the statute events two through four are terrorism, assassination, and war. The inclusion of these activities clearly demonstrates that the scope of Section 5c(c)(5)(C) and Rule 40.11 includes contracts when the activity underlying the event contract involves one of the enumerated activities. The act of participating in a contract is not itself an act of terrorism, assassination, or war.¹⁸ The same analytical approach, by extension, should apply to each of the items on the list, including an “activity that is unlawful under any Federal or State law” and “gaming.” Otherwise, Section 5c(c)(5)(C) would be internally inconsistent, contrary to the traditional tools of construction.

Second, Section 5c(c)(5)(C) and Rule 40.11 allow the Commission to prohibit the listing of an event contract only “if the agreements, contracts, or transactions **involve**” any of the enumerated activities that are against the public interest. Event contracts that do not involve any of the enumerated activities may be listed for trading because the special rule would not prohibit the listing of those contracts by a DCM.

Third, Section 5c(c)(5)(C) places an additional, key limitation on the “agreements, contracts, or transactions” within the scope of the text. Those “agreements, contracts, or transactions” must be “in excluded commodities that are based upon the occurrence, extent of an occurrence, or contingency.” The reference to “occurrence” or “contingency” can only mean to the underlying event of the contract, not the contract itself. The contract cannot reasonably be described as an occurrence or a contingency. Indeed, the headings of the section—“Special rule for review and approval of event contracts and swap contracts” (Section 5c(c)(5)(C)) and “Event Contracts” (Section 5c(c)(5)(C)(i))—reinforce Congress’ focus on the “event” or occurrence, not the trading

¹⁷ *Provisions Common to Registered Entities: Proposed Rule*, 75 Fed. Reg. 67,282, 67,283 (Nov. 2, 2010) (“Section 745 of the Dodd-Frank Act also authorizes the Commission to prohibit the listing of event contracts based on certain excluded commodities if such contracts involve one or more **activities** enumerated in the Dodd-Frank Act.”) (emphasis added) (“40.11 Proposed Rule”); *see id.* at 67,289 (“If [] the Commission determines that such product may involve an **activity** that is enumerated in 40.11 . . .”) (emphasis added).

¹⁸ To illustrate this point, consider hypothetical contracts on whether a foreign leader will be assassinated, how many Russian planes will be shot down by Ukrainian forces, or how many murders will occur in a given city over a certain time period. Section 5c(c)(5)(C) and Rule 40.11 would apply to these hypothetical contracts because the activities underlying the contracts in these hypothetical examples are the enumerated activities of “assassination,” “war,” and “an activity that is unlawful under Federal or State law.” The purchasing of the contract itself, however, is not “an activity” of “assassination,” “war,” or “an activity that is unlawful under Federal or State law.”

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of the contract. Thus, the text and structure of Section 5c(c)(5)(C) clearly and meaningfully limit the Commission's reach regarding event contracts.

Because the text and structure is clear, there is no need to resort to legislative history. That is a bedrock principle of the traditional tools of statutory construction. Nevertheless, the sparse legislative history regarding Section 5c(c)(5)(C)¹⁹ provides no guidance as to whether Congress intended the Commission to limit the scope of Section 5c(c)(5)(C) to instances where the underlying activity of an event contract is one of the enumerated events.

This reading of Section 5c(c)(5)(C) is consistent with the terms used by the Commission in Rule 40.11. Rule 40.11 borrows heavily from the terms used in the statute, including multiple uses of "activity" in both subsections 40.11(a). The Regulation also uses the same term "involves" which appears in the Statute, but also adds the phrase "relates to, or references" when describing enumerated activities. Because "involves" is the only statutory authority provided by Congress, the Commission cannot expand upon the scope of that term. Thus, the only way to read "relates to, or references" consistent with the Commission's authority is that they are the specific meanings of "involves" that the Commission adopted.²⁰ The terms "relates to" and "references," in turn, clearly describe the underlying activity upon which the event contract is based. It would be nonsensical to interpret "relates to" and "references" as describing the act of participating in the event contract itself.

To be clear, Congress could certainly promulgate a law that covers the *participation* in an event contract. But Section 5c(c)(5)(C) is not that law. Instead, applying the traditional tools of construction, Congress enacted Section 5c(c)(5)(C) to prohibit a narrow group of contracts whose underlying activities are the enumerated activities and the CFTC has determined are contrary to

¹⁹ The only legislative history that has been cited by the Commission regarding Rule 40.11 involves a short colloquy between Senator Feinstein of California and Senator Lincoln of Arkansas on July 15, 2010. *See, e.g.*, 40.11 Final Rule, 76 Fed. Reg. at 44,786 & nn. 34-35; *see also* Nadex Order, Whereas Clauses 2 & 7. This 555-word back-and-forth between two Senators, which takes up less than two columns of one page of the Congressional Record (Volume 156, Issue 105, S5906-5907 (July 15, 2010)), is particularly weak evidence of the intent of Congress as a whole and the meaning of the provision. *See, e.g.*, *NLRB v. SW General, Inc.*, 137 S. Ct. 929, 943 (2017) ("[F]loor statements by individual legislators rank among the least illuminating forms of legislative history."). The text is by far the more probative evidence of Congress' meaning. The Nadex Order's extensive reliance on this sparse legislative history is simply inconsistent with the interpretive approach laid out in *Kisor* and provides an additional reason why Kalshi can self-certify the contracts notwithstanding the Nadex Order. In any event, none of the short legislative history specifically addresses the question about whether Section 5c(c)(5)(C) applies only to the underlying events or the trading of the contracts as well, so it has nothing to add to this analysis.

²⁰ Rule 40.11 cannot exceed the scope of Section 5c(c)(5)(C). Any interpretation of Rule 40.11 that views it as expanding the scope delineated in Section 5c(c)(5)(C) would run afoul of the Constitution's separation of powers and the Administrative Procedure Act.

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the public interest and those limitations apply to Rule 40.11. If the underlying activity of a contract is not an enumerated event, it is outside the scope of Section 5c(c)(5)(C) and Rule 40.11.

B. The Nadex Order Incorrectly Interprets And Applies Section 5c(c)(5)(C) And Rule 40.11 To Apply To Political Control Contracts Like Kalshi's.

As described above, Section 5c(c)(5)(C) and Rule 40.11 apply only to the listing of event contracts whose underlying activity involves one of the six enumerated activities. They do not apply to event contracts whose underlying activity does not involve one of the enumerated activities. This key distinction between the activity itself or a *contract on the activity* is of particular importance for the Kalshi contracts at issue here. The underlying activity of Kalshi's contracts is political control of the chambers of Congress. Political control of Congress is none of the activities identified in Section 5c(c)(5)(C) and, as such, Kalshi's political control contracts are not subject to the special rule.

The Nadex Order's contrary conclusion was incorrectly reasoned and misapplied in several aspects.²¹ First, contrary to the above explanation, the Nadex Order incorrectly expanded the scope of the statute and regulation to include the act of participating in the contract, and not just the underlying activity. Second, the Nadex Order incorrectly includes election contracts in the enumerated activities of illegal under state law and gaming.

The Nadex Order incorrectly expanded the scope of Section 5c(c)(5)(C) and Rule 40.11 to include the act of participating in the contract, and not just the underlying activity. The first enumerated activity of Section 5c(c)(5)(C) is "activity that is unlawful under any Federal or State law." The underlying activity of Kalshi's contracts is political control of the chambers of Congress. There is no Federal or State law that makes political control of Congress illegal. There is also no Federal or State law that prohibits elections or voting in elections which result in the political control of Congress. Accordingly, political control contracts would not fall under the special rule's enumerated act of "illegal activity."

To be sure, 27 states do prohibit, in one form or another, betting on elections. And the Nadex Order (incorrectly) stated that "state gambling definitions of 'wager' and 'bet' are analogous to the act of taking a position in the Political Event Contracts"²² as a justification for prohibiting those contracts' listing. In this regard, however, the Nadex Order overextended. Section 5c(c)(5)(C) is limited to the activity underlying the contract, not the participation in the contract itself.

²¹ As noted previously (*see supra* nn. 4-14), the Commission adopted the Nadex Order prior to the Supreme Court's decision in *Kisor v. Wilkie* and thus the Order did not use the framework now required by the Supreme Court for evaluating the scope and implications of Rule 40.11.

²² Nadex Order at 2.

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The Nadex Order also misapplies the enumerated activity of “gaming.” There are at least two fundamental differences between the relevant state gaming or gambling laws and event contracts. As Commissioner Brian Quintenz described with regards to the withdrawn ErisX sports event contract, trading an event contract with a binary outcome is not automatically considered a gamble.²³ Indeed, if Section 5c(c)(5)(C) had assumed that participating in any event contract involved making a wager or gamble, there would have been no need for Congress to individually enumerate “gaming” as a distinct category of event contracts upon which the Commission could make a public interest determination. The fact that Congress separated “gaming” from other event contracts is a clear indication that Congress did not intend for all event contracts to be considered gaming.

In fact, the statutory definition of “bet” or “wager” used by the Nadex Order itself, in the same statute, clearly indicates that not all CFTC regulated products are gaming. The statute cited by the Nadex Order²⁴ for defining “bet” or “wager” is 31 U.S.C. § 5362(1), a part of the Unlawful Internet Gambling Enforcement Act of 2006. That definition of “bet or wager,” however, includes two relevant exclusions. First, the term “bet or wager” does not include “any transaction conducted on or subject to the rules of a registered entity or exempt board of trade under the Commodity Exchange Act.”²⁵ The term also does not include “any other transaction that is excluded or exempt from regulation under the Commodity Exchange Act.”²⁶ The statute cited by the Nadex Order itself demonstrates that the Nadex Order’s expansive application of Section 5c(c)(5)(C) and Rule 40.11 is incorrect.

The Nadex Order’s broad interpretation of gaming under the statute and rule would result in prohibiting much of the legally registered activity that the CFTC has previously approved. Indeed, many states ban “gambling” not just on elections, but specifically on the outcomes of future events. For example, New Hampshire bans gambling and defines it as “to risk something of value upon a future contingent event not under one’s control or influence”²⁷ while North Carolina includes a

²³ See Statement of Commission Brian D. Quintenz on ErisX RSBIX NFL Contracts and Certain Event Contracts (Mar. 25, 2021) (available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/quintenzstatement032521>) (last visited May 30, 2022). The many other distinctions between an event contract and a gamble include the fact that betting is a game of pure chance without any economic utility while event contracts are non-chance driven outcomes with economic utility.

²⁴ Nadex Order at 3.

²⁵ 31 U.S.C. § 5362(1)(a)(E)(ii).

²⁶ *Id.* § 5362(1)(a)(E)(iv)(I).

²⁷ NH Rev Stat § 647:2(II)(d) (2017); see also Alaska Stat. § 11.66.280(3) (“gambling” means that a person stakes or risks something of value upon the outcome of a contest of chance or a future contingent event not under the person’s control or influence, upon an agreement or understanding that that person or someone else will receive something of

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wager on an “unknown or contingent event” in its statutory definition of gambling.²⁸ New York defines gambling as staking or risking something of value upon the outcome of a contest of chance or a future contingent event not under his control or influence, upon an agreement or understanding that he will receive something of value in the event of a certain outcome.²⁹ Other states explicitly prohibit trading on the future delivery of securities and commodities without delivery and which are purely cash-settled, as is normal for products like stock index futures and eurodollar futures.³⁰ In all, 19 states contain provisions in their state codes that prohibit the listing of at least some subset of contracts that the CFTC has approved.³¹

Under the Nadex Order’s reasoning, because Rule 40.11 prohibits the listing of contracts that “involve” “gaming,” laws like these would prohibit *all* event contracts. For example, event contracts on the weather and various economic indicators would be considered “risking something of value upon a future contingent event not under one’s control or influence.” And yet, not only are these event contracts a staple of CFTC regulated DCMs, but the Commission’s Core Principles require that event contracts be specifically outside the control or influence of a market participant and not readily susceptible to manipulation. The Nadex Order’s application of Rule 40.11 would therefore preclude the CFTC from regulating any event contract because event contracts are considered gambling under (some) state laws.³² Because such an interpretation of “gaming” would lead to absurd results, the traditional tools of interpretation and the process required by the

value in the event of a certain outcome”); Or. Rev. Stat. § 167.117(7) (“‘Gambling’ means that a person stakes or risks something of value upon the outcome of a contests of chance or a future contingent event not under the control or influence of the person . . .”).

²⁸ N.C. Gen. Stat. § 16-1.

²⁹ NY Penal Law, Chapter 40, Part 3, Title M, Article 225.

³⁰ For example, the laws of South Carolina, Oklahoma, and Mississippi use the following language: “Any contract of sale for the future delivery of cotton, grain, stocks or other commodities . . . upon which contracts of sale for future delivery are executed and dealt in without any actual bonafide execution and the carrying out or discharge of such contracts upon the floor of such exchange, board of trade, or similar institution in accordance with the rules thereof, shall be null and void and unenforceable in any court of this state, and no action shall lie thereon at the suit of any party thereto.”

³¹ Moreover, the purpose of the CEA, CFMA and other laws was to create clear and consistent national guidelines; a contrary interpretation would lead to the undesirable result that if one state prohibited a specific kind of contract then the Commission could use the special rule to ban that contract in all states.

³² On this point, it seems that at the very least, Rule 40.11 would be an APA violation, or even unconstitutional, if the analysis in Nadex Order was taken to its logical conclusion because of its dramatic impacts on the regulatory scheme. *Cf. Whitman v. American Trucking Ass’ns, Inc.*, 531 U.S. 457, 468 (2001) (“Congress, we have held, does not alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions—it does not, one might say, hide elephants in mouseholes.”).

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Supreme Court in *Kisor* demonstrate that the Nadex Order's view cannot be the correct way to interpret Rule 40.11.³³

Seen in this context, the state laws that prohibit gambling on elections do not and cannot refer to CFTC regulated event contracts. The laws of many states prohibit gambling on event contracts, case-settled commodity futures contracts, and elections as one. Yet, the CFTC clearly continues to regulate and approve of the event contracts and cash-settled commodity futures markets even though it may seem to conflict with those state laws.³⁴ Event contracts relating to elections should be no different. Indeed, just as other event contracts regulated by the CFTC, Kalshi's political control contract should also not be precluded by the gaming provisions of Rule 40.11.

Furthermore, the CFTC's actions and inactions since the Nadex Order indicate that even the Commission has not continued the Nadex Order's reasoning in this regard. Consider, for example, the Small Cannabis Equity Index Futures Contract listed by the Small Exchange. The Cannabis Index involves the stock prices of companies in the cannabis industry that produce and distribute cannabis for consumption—an activity that is unlawful under Federal law and many State laws. The contract is “dependent on the occurrence, nonoccurrence, or the extent of the occurrence” of an event with “potential financial, economic, or commercial consequence,”³⁵ namely the value of the Cannabis Index. The activities of these companies are production and distribution of cannabis for consumption, which are all activities that are “unlawful under Federal and [many] State laws,”

³³ See, e.g., *Tennessee Wine & Spirits Retailers Ass'n v. Thomas*, 139 S. Ct. 2449, 2462 (2019) (“reading § 2 [of the Twenty-First Amendment] to prohibit the transportation or importation of alcoholic beverages in violation of *any* state law would lead to absurd results that the provision cannot have been meant to produce”) (emphasis in original). Indeed, the “Commission agrees that the term ‘gaming’ requires further clarification and that the term is not susceptible to easy definition.” *Provisions Common to Registered Entities: Final Rule*, 76 Fed. Reg. 44,776, 44,785 (July 27, 2011). In the 40.11 Final Rule, the Commission noted that it had previously sought comments regarding event contracts and gaming in 2008 and that the “Commission continues to consider these comments and may issue a future rulemaking concerning the appropriate regulatory treatment of ‘event contracts,’ including those involving ‘gaming.’” 40.11 Final Rule at 44,785. “In the meantime, the Commission has determined to prohibit contracts based upon the activities enumerated in Section 745 of the Dodd-Frank Act and to consider individual product submissions on a case-by-case basis under 40.2 or 40.3.” *Id.* That process is undermined if the Nadex's Order's approach to “gaming” stands.

³⁴ The CFMA explicitly preempts the application of state gambling statutes when it applies to legal commodity futures contracts and as such there is also a federal preemption argument here that the state gambling statutes should not be considered, regardless of the Nadex Order's misapplication of Rule 40.11. See 7 U.S.C. § 16(e)(2) (“This chapter shall supersede and preempt the application of any State or local law that prohibits or regulates gaming or the operation of bucket shops (other than antifraud provisions of general applicability) in the case of—(A) an electronic trading facility excluded under section 2(e) of this title; and (B) an agreement, contract, or transaction that is excluded from this chapter under section 2(c) or 2(f) of this title or sections 27 to 27f of this title, or exempted under section 6(c) of this title (regardless of whether any such agreement, contract, or transaction is otherwise subject to this chapter).”).

³⁵ See 7 U.S.C. § 1a(19) (definition of excluded commodity).

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and should otherwise fall under the purview of Section 5c(c)(5)(C) and Rule 40.11. Certainly, if Section 5c(c)(5)(C) was given the same broad reading that the Commission gave to it in the Nadex Order, the Cannabis Equity Index would certainly “involve” an enumerated activity and be subject to Section 5c(c)(5)(C) and Rule 40.11. Yet, the Cannabis Index contract was self-certified and the Commission did not invoke Section 5c(c)(5)(C) or Rule 40.11. Therefore, it is clear that the Commission has not maintained the Nadex Order’s overbroad and incorrect reading of the Statute and Rule 40.11.

Even if the proposed Kalshi contracts somehow came within the scope of Section 5c(c)(5)(C) and Rule 40.11, that does not preclude them from being listed. I understand that Kalshi has made submissions to the Commission demonstrating offering the contracts would be in the public interest. A full discussion of those points is outside the scope of this letter. I do note, however, that the Commission is not limited to using an economic purpose test for determining whether a contract is within the public interest. That test is found nowhere in the text of Section 5c(c)(5)(C) or Rule 40.11. One reference to the economic purpose test between two Senators in a brief discussion of what would become Section 5c(c)(5)(C) is insufficient to bind the Commission to that test.³⁶ The Commission recognized as much in the Nadex Order itself, stating “the Commission has the discretion to consider other factors in addition to the economic purpose test in determining whether an event contract is contrary to the public interest.”³⁷

Furthermore, as a procedural matter, there is nothing in the CEA or Rule 40.11 requiring the Commission to act on Kalshi’s self-certification of the political control contracts discussed in this letter. Both Section 5c(c)(5)(C) and Rule 40.11 speak in terms that the Commission “may determine.”³⁸

At the end of the day, Kalshi has various arguments to justify the self-certification of the contracts described above.

³⁶ See supra note 19 (discussing limitations of floor statements as persuasive evidence of a statute’s meaning).

³⁷ Nadex Order at 4.

³⁸ 7 U.S.C. § 7a-2(c)(5)(C)(i) (“the Commission **may determine** that such agreements, contracts, or transactions are contrary to the public interest . . .”) (emphasis added); 7 C.F.R. § 40.11(c) (“The Commission **may determine** . . . that a contract . . . be subject to the 90-day review.”) (emphasis added).

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Please let me know if you need anything further.

Sincerely,

Daniel J. Davis

Daniel J. Davis

DJD:dml

Public Statements & Remarks

Dissenting Statement of Commissioner Caroline D. Pham Regarding the Review and Stay of KalshiEX LLC's Political Event Contracts

August 26, 2022

I respectfully dissent from the Commission's decision pursuant to CFTC Rule 40.11 to require a review and impose a stay of up to 90 days on KalshiEX LLC's (Kalshi) Congressional control political event contracts, because Rule 40.11 does not apply to the contracts and because the appropriate process is to review the contracts under Rule 40.3.

I would like to first thank staff in the Division of Market Oversight for their hard work and diligence on this matter. The CFTC is able to effectively oversee our markets due to the experience and expertise of our staff, and they are to be commended for their dedication and faithful service.

I. BACKGROUND

A. Kalshi voluntarily submitted political event contracts for Commission approval pursuant to CFTC Rule 40.3.

Kalshi, a CFTC-registered Designated Contract Market (DCM), voluntarily submitted^[1] the political event contracts for approval by the Commission pursuant to CFTC Rule 40.3^[2] on July 20, 2022, after engaging in approximately 36 meetings with the Commission and staff over nearly a year (since late 2021), and numerous meetings with members of Congress.

Kalshi states that the political event contracts are permitted under the Commodity Exchange Act (CEA) and CFTC rules because, among other things: 1) Section 5c(c)(5)(C) and Rule 40.11 do not apply to the contracts because the underlying event of political control of Congress is neither gaming nor illegal under Federal or State law; 2) the contracts can be used to hedge predictable financial, economic, and commercial consequences; 3) the contracts would not negatively affect election integrity or the perception of election integrity; and 4) similar contracts can already be accessed by U.S. persons on other markets that are not registered or otherwise regulated by the Commission.

II. DISCUSSION

A. CEA section 5c(c)(5)(C) and CFTC Rule 40.11 apply only to certain event contracts based upon specifically enumerated activities.

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Section 5c(c)(5)(C) provides that certain event contracts may be prohibited from being listed or made available for clearing or trading if the Commission determines such event contracts to be “contrary to the public interest” because they “involve” certain enumerated activities: an “(I) activity that is unlawful under any Federal or State law; (II) terrorism; (III) assassination; (IV) war; (V) gaming; or (VI) other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.”[3]

The Commission exercised its discretion under Section 5c(c)(5)(C) (i.e., “may determine”) to promulgate its implementing Rule 40.11.[4] Rule 40.11(a) sets forth a prohibition on the trading and clearing of any event contract[5] that “involves, relates to, or references” (1) “terrorism, assassination, war, gaming, or an activity that is unlawful under any State or Federal law”[6]; or (2) “an activity that is similar to an activity enumerated in 40.11(a)(1) of this part, **and** that the Commission determines, **by rule or regulation**, to be contrary to the public interest” (emphasis added).[7] Rule 40.11(b) is reserved.[8]

Rule 40.11(c) provides that the Commission may require a 90-day review if the event contract “may involve, relate to, or reference an activity enumerated in 40.11(a)(1) or 40.11(a)(2).”[9] Rule 40.11(c) (1) requires that the listing or trading of the event contract be suspended (stayed) during the 90-day review period.[10] Rule 40.11(c)(2) requires that the Commission issue an order approving or disapproving the contract at the end of the 90-day review period (or such other extended time period as agreed to by the registered entity (for example, a DCM)).

In promulgating Rule 40.11(a)(1) pursuant to Section 5c(c)(5)(C), the Commission determined that an event contract that “involves, relates to, or references” terrorism, assassination, war, gaming, or illegal activity is prohibited because it is contrary to the public interest.[11] There is no further public interest test in Rule 40.11(a)(1); per the operation of the statute, the Commission must have *already* made its determination that the event contract is contrary to the public interest in order to prohibit its being listed for trading or accepted for clearing.[12] Therefore, the Commission has no discretion to infer an additional case-by-case public interest test[13] under Rule 40.11(a)(1) because the plain meaning of both the statutory text and the rule text is clear and unambiguous. An event contract is only prohibited under Rule 40.11(a)(1) if it is based upon the underlying activity of terrorism, assassination, war, or gaming, or an activity that is unlawful under any State or Federal law.[14]

Further, Rule 40.11(a)(2) prohibits an event contract that “involves, relates to, or references an activity that is similar to an activity enumerated in 40.11(a)(1),” *only if* the Commission has already promulgated a rule or regulation to determine that such activity is contrary to the public interest.[15]

Indeed, the preamble to the final rulemaking for Rule 40.11 explicitly states, “[The Commission] has determined not to propose such regulations at this time.”[16] Therefore, Rule 40.11(a)(2) is not operative because the Commission has never satisfied the predicate condition of promulgating a rule or regulation in order to determine an activity that is similar to an enumerated activity is contrary to the public interest.[17] Further, the rule text is clear on its face that the public interest test in Rule 40.11(a)(2) can only be applied through a rulemaking, and can only be applied to the underlying activity that is similar to an enumerated activity, as provided by Section 5c(c)(5)(C)(VI).[18]

B. The political event contracts are not based on any enumerated activities under Rule 40.11(a)(1), and the contracts are not subject to Rule 40.11(a)(2) because it is not operative.

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Both Section 5c(c)(5)(C) and Rule 40.11 set forth language that refers to contracts that are based upon an event that involves an enumerated activity.[19] And in the preamble to the final rulemaking for Rule 40.11, the Commission describes the rule as applicable to “contracts *based upon* the [enumerated activities] . . .” (emphasis added).[20] The preamble shows that whether an event contract is prohibited by Rule 40.11 depends on the underlying activity that the contract is based upon—the underlying activity that the contract “involves, relates to, or references.”[21] With respect to the political event contracts here, the underlying activity is political control.

The Commission must apply the same Congressional intent to each of the enumerated activities, including an “activity that is unlawful under any Federal or State law” and “gaming.” Otherwise, Section 5c(c)(5)(C)(i) would be internally inconsistent and in conflict with “‘traditional tools’ of statutory construction.”[22]

Accordingly, because “political control” is neither terrorism, assassination, war, gaming, nor unlawful under any Federal or State law, Rule 40.11(a)(1) does not apply to the political event contracts. And, as discussed in II.A., Rule 40.11(a)(2) is not operative until the Commission promulgates a rule or regulation to determine that an activity that is “similar to” an enumerated activity is contrary to the public interest,[23] therefore, Rule 40.11(a)(2) does not apply to the political event contracts.

C. The Commission must apply principles of fair competition and fair treatment to similar contract markets.

We must apply our rules fairly. Congress has mandated that the CFTC promote responsible innovation and fair competition.[24] The Commission is already allowing an unregistered event contract market, PredictIt, to continue to operate its political control markets through the November 2022 election cycle and until Feb. 15, 2023.[25] But the Commission has not taken any action on Kalshi’s contracts, even though Kalshi submitted their request for voluntary approval over a month ago, and have been discussing it with the CFTC for almost a year.

In the interest of fair competition and fair treatment, Kalshi, a CFTC registered entity, should be allowed to operate their political control markets as well. Although the Commission’s notification letter acknowledges that this issue is “time-sensitive” and that the Commission “will endeavor” to make a decision on the political event contracts by October 28, 2022, the Commission does not actually have to stick to that date.

And even *if* the Commission does make a decision by October 28 (and the decision is to approve—not deny—the contracts), Kalshi would only be able to realistically operate its political control markets for a couple of days before the November midterm elections.

The outcome is the same: the Commission’s action to impose a stay will essentially run out the clock on Kalshi’s ability to list contracts for the November 2022 elections. I believe that it is only fair for either both exchanges to list the political control contracts, or neither of them should.

D. The 2012 Nadex order is not binding precedent on the Commission with respect to the Kalshi political event contracts.

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In addition, the Commission should evaluate the issues presented by the Kalshi political event contracts as a matter of first impression. The Commission's 2012 order prohibiting North American Derivatives Exchange's (Nadex) political event contracts was specific to Nadex's contracts and did not create a broad limitation or rule of general applicability.[26]

III. CONCLUSION

Rule 40.11(a)(1) does not apply to the political event contracts here because they are based upon the underlying activity of political control, which is not an enumerated activity, and there is no additional required public interest test. Rule 40.11(a)(2) is not operative because the Commission has not determined by rule or regulation that similar activity is contrary to the public interest.

Therefore, the Commission cannot exercise Rule 40.11(c) to require a review and impose a stay of Kalshi's contracts. However, the Commission can review the political event contracts pursuant to the process set forth under Rule 40.2 or 40.3, as applicable.

Further, when the Commission reviews a contract under Rule 40.2 or 40.3, it includes review for compliance with the CEA and Commission regulations—including section 5c(c)(5)(C) and Rule 40.11.[27] Indeed, the preamble to the final rulemaking for Rule 40.11 states that the Commission will “consider individual product submissions on a case-by-case basis under § 40.2 or § 40.3,” including the applicability of § 40.11(a).[28] In addition, the Commission can request comment from the public at any time and does not need to use Rule 40.11 to do so.

The Commission should engage with the public in a transparent manner. Kalshi has proactively and extensively discussed the political event contracts with the Commission and staff over the course of approximately 36 meetings for nearly a year. Not only that, but Kalshi has also had many meetings with members of Congress. In all that time, if the Commission had a concern that the political event contracts violate CEA section 5c(c)(5)(C) and CFTC Rule 40.11, or if the Commission did not ever intend to allow the contracts to be traded, then the Commission should have said so. We should say what we mean and mean what we say.

Businesses make material strategic and commercial decisions that have material impacts on their operations and performance, based on regulatory engagement with the Commission. Lost opportunities may never be regained. The “regulatory burn rate” is real, and we should be transparent so that businesses can get the information they need to move forward and redeploy capital to more productive use.

I look forward to receiving comments from the public on these important issues.

[1] Kalshi is not prevented from withdrawing the request for approval and self-certifying the contracts pursuant to CFTC Rule 40.2.

[2] 17 C.F.R. § 40.3(a).

[3] 7 U.S.C. § 7a–2(c)(5)(C)(i)(I)–(VI).

[4] Provisions Common to Registered Entities, 76 Fed. Reg. 44776, 44786 (July 27, 2011).

[5] Rule 40.11 defines an event contract as “[a]n agreement, contract, transaction, or swap based upon an excluded commodity, as defined in Section 1a(19)(iv) of the [CEA].” 17 C.F.R. § 40.11(a)(1).

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[6] 17 C.F.R. § 40.11(a)(1).

[7] 17 C.F.R. § 40.11(a)(2).

[8] 17 C.F.R. § 40.11(b).

[9] 17 C.F.R. § 40.11(c).

[10] 17 C.F.R. § 40.11(c)(1).

[11] See 76 Fed. Reg. at 44786 (“[T]he Commission would like to note that its prohibition of certain ‘gaming’ contracts is . . . to ‘protect the public interest from gaming and other event contracts.’”) and at 44786, FN 35 (“[T]he Commission ‘needs the power to, and should, prevent derivatives contracts that are contrary to the public interest because they exist predominantly to enable gambling through supposed event contracts.’”); see also 7 U.S.C. § 7a–2(c)(5)(C)(i) (“[T]he Commission may determine that such [event contracts] are contrary to the public interest if the [event contracts] involve [the enumerated activities].”).

[12] See 7 U.S.C. § 7a–2(c)(5)(C)(ii) (“**Prohibition.** No [event contract] determined by the Commission to be contrary to the public interest [because it involves an enumerated activity] may be listed or made available for clearing or trading . . .”).

[13] The preamble to the final rulemaking for Rule 40.11 states that the Commission will “consider individual product submissions on a case-by-case basis under § 40.2 or § 40.3,” including the applicability of § 40.11(a). However, this does not mean that the Commission will apply a public interest test on a case-by-case basis, which is not provided for under Rule 40.11(a)(1), and may only be applied through a rulemaking under Rule 40.11(a)(2).

[14] See 76 Fed. Reg. at 44785 (“[T]he Commission has determined to prohibit contracts based upon the [enumerated activities].”). Cf. FN 15, *infra* (“prohibit products that are based upon activities. . .”).

[15] See FN 7, *supra*.

[16] 76 Fed. Reg. at 44786 (“The Commission may, at some future time, adopt regulations that prohibit products that are *based upon activities* ‘similar to’ [the enumerated activities]. It has determined not to propose such regulations at this time.”) (emphasis added).

[17] *Id.*

[18] 17 C.F.R. § 40.11(a)(2).

[19] 7 U.S.C. § 7a–2(c)(5)(C)(i) (“In connection with the listing of agreements, contracts, transactions, or swaps in excluded commodities that are *based upon* the occurrence, extent of an occurrence, or contingency [*i.e.*, event] . . . if the agreements, contracts, or transactions involve [an enumerated *activity*] . . .”) (emphasis added), 17 C.F.R. § 40.11(a)(1)–(2) (“An agreement, contract, transaction, or swap *based upon* an [event], that involves, relates to, or references [an enumerated *activity* or similar *activity*] . . .”) (emphasis added).

[20] See FN 13, *supra*.

[21] As an example, terrorism, assassination, and war are three of the activities enumerated by Section 5c(c)(5)(C)(i) and Rule 40.11(c)(1). Trading an event contract based upon one of these activities is not in itself an act of terrorism, assassination, or war. It is clear that Congress intended the prohibition to apply to event contracts where the activity underlying the contract is one of the enumerated activities.

[22] *Kisor v. Wilkie*, 139 S. Ct. 2408, 2415 (2019) (quoting *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843, n. 9 (1984)).

[23] See FN 15, *supra*.

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[24] 7 U.S.C. § 5(b).

[25] CFTC Letter No. 22-08, Withdrawal of CFTC Letter No. 14-130 (Aug. 4, 2022). As of August 15, 2022, PredictIt lists contracts on whether the Democrat or Republican party will control the Senate after 2022, and whether the Democrat or Republican party will win the House in 2022.

[26] In the Matter of the Self-Certification by North American Derivatives Exchange, Inc. of Political Event Derivatives Contracts and Related Rule Amendments under Part 40 of the Regulations of the Commodity Futures Trading Commission (Apr. 2, 2012), *available at* <https://www.cftc.gov/sites/default/files/idc/groups/public/%40rulesandproducts/documents/ifdocs/nadexorder040212.pdf> ([/sites/default/files/idc/groups/public/%40rulesandproducts/documents/ifdocs/nadexorder040212.pdf](https://www.cftc.gov/sites/default/files/idc/groups/public/%40rulesandproducts/documents/ifdocs/nadexorder040212.pdf)). *Cf.* 5 U.S.C. § 553.

[27] *See* FN 13, *supra*.

[28] *Id.*

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U.S. COMMODITY FUTURES TRADING COMMISSION

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June 23, 2023

Xavier Sottile
Head of Markets
KalshiEX LLC
594 Broadway
New York, NY 10012

Re: Notification of Commodity Futures Trading Commission (“Commission”) Commencement of 90-day Review of “Will <chamber of Congress> be controlled by <party> for <term>?” Contracts

Dear Mr. Sottile:

This is to inform you that, pursuant to Commission regulation 40.11(c), the Commission has commenced a 90-day review of the KalshiEX LLC (“Kalshi”) self-certified submission dated June 12, 2023 (the “Submission”) of “Will <chamber of Congress> be controlled by <party> for <term>?” contracts (the “Congressional Control Contracts”). The Commission has determined that the Submission comprises contracts that may involve, relate to, or reference an activity enumerated in Commission regulation 40.11(a)(1) and section 5c(c)(5)(C)(i) of the Commodity Exchange Act. Accordingly, the Commission requests, pursuant to Commission regulation 40.11(c)(1), that Kalshi suspend any listing and trading of the Congressional Control Contracts during the pendency of the Commission’s 90-day review period, which will commence as of the date of this notification letter.

Please note that, consistent with Commission regulation 40.11(c)(1), the Commission will post on its website a notification of its intent to carry out a 90-day review of the Submission. Please further note that the Commission has decided to open a 30-day public comment period within the 90-day review period to assist the Commission in its evaluation of the Submission. To do so, the Commission intends to supplement the notification posted on the Commission’s website with the publicly filed portion of the Submission and specific questions regarding the Congressional Control Contracts.

If you have any questions regarding this notification, please contact Chris Goodman (cgoodman@cftc.gov; (202) 418-5616).

Sincerely,

Christopher J. Kirkpatrick
Secretary of the Commission

Release Number 8728-23

CFTC Announces Review of Kalshi Congressional Control Contracts and Public Comment Period

June 23, 2023

Washington, D.C. — The Commodity Futures Trading Commission today announced that it has commenced a review of contracts self-certified by KalshiEX, LLC (Kalshi) on which political party will be in control of each chamber of the U.S. Congress, under CFTC Regulation 40.11(c). Kalshi, a designated contract market, submitted the contracts to the CFTC following the close of business on June 12, 2023. The CFTC has 90 days subsequent to the date that it commences review, or if applicable, until the conclusion of such extended period agreed to or requested by Kalshi, to make a determination with respect to the contracts.

As described in Kalshi's submission, the contracts are cash-settled, binary contracts based on the question: "Will <chamber of Congress> be controlled by <party> for <term>?" The contracts settle based on the party affiliation of the Speaker of the U.S. House of Representatives or the President Pro Tempore of the U.S. Senate. The CFTC has determined the contracts may involve, relate to, or reference an activity enumerated in CFTC Regulation 40.11(a) and section 5c(c)(5)(C) of the Commodity Exchange Act and has therefore commenced a review pursuant to CFTC Regulation 40.11(c).

As required under CFTC Regulation 40.11(c)(1), the CFTC has requested that Kalshi refrain from listing or trading the contracts during the CFTC's review period.

The CFTC seeks public comment on specific questions related to Kalshi's self-certified congressional control contracts during a 30-day public comment period. The questions are available here (<https://www.cftc.gov/media/8801/DMOKalshiQuestions062323/download>). The public comment period ends on July 24, 2023.

Kalshi's publicly-filed submission, which provides detailed information about the contracts, is available here (<https://www.cftc.gov/IndustryOversight/IndustryFilings/TradingOrganizationProducts/50934>).

-CFTC-

Questions on the KalshiEX LLC “Will <chamber of Congress> be controlled by <party> for <term>?” Contracts for Public Comment

1. Do these contracts involve, relate to, or reference gaming as described in Commission regulation 40.11(a)(1) and section 5c(c)(5)(C) of the Commodity Exchange Act, or in the alternative, involve, relate to, or reference an activity that is similar to gaming as described in Commission regulation 40.11(a)(2) and section 5c(c)(5)(C) of the Commodity Exchange Act?
2. What role does the requirement that the contracts trade in multiples of 5000 and/or the position limits applicable to the contracts play in the analysis of whether the contracts involve, relate to, or reference gaming as described in Commission regulation 40.11(a)(1) and section 5c(c)(5)(C) of the Commodity Exchange Act? Are the position limits reasonably enforceable?
3. Should the Commission consider whether similar offerings are available in traditional gaming venues such as casinos or sports books and/or whether taking a position on elections or congressional control is defined as gaming under state or federal law?
4. Do these contracts involve, relate to, or reference “an activity that is unlawful under any State or Federal law” as described in Commission regulation 40.11(a)(1) and section 5c(c)(5)(C) of the Commodity Exchange Act?
5. In determining whether these contracts involve an activity that is unlawful under any State or Federal law, should the Commission be influenced by whether state laws permit betting on the outcome of elections or other political outcomes and/or by the prohibition of interstate betting under Federal law?
6. Are the contracts substantively different from Nadex’s previously proposed political event contracts such that the Commission’s analysis should be different? For reference, please see “CFTC Order Prohibiting North American Derivatives Exchange’s Political Event Derivatives Contracts” (Apr. 2, 2012), available at <https://www.cftc.gov/PressRoom/PressReleases/6224-12>.
7. Are the contracts substantively different from Kalshi’s previously proposed, and withdrawn, congressional control contracts? For reference, please see “CFTC Announces Review and Comment Period of KalshiEX Proposed Congressional Control Contracts Under CFTC Regulation 40.11” (August 26, 2022), available at <https://www.cftc.gov/PressRoom/PressReleases/8578-22>.
8. Do the contracts serve a hedging function? What standard should be used in reviewing the contracts’ hedging function? Is it sufficient that a contract could theoretically be used for hedging, or should an exchange provide evidence of demonstrated need by likely hedgers in the market? How often must a contract be used for hedging or what percentage of market participants or open interest must represent hedging use in order for a contract to serve a hedging function?

9. Are there unique economic risks tied to the outcome of congressional control that cannot be hedged via derivative products on equities, debt, interest rates, tax rates, asset values, and other commodity prices?
10. Are the economic consequences of congressional control predictable enough for a contract based on that control to serve a hedging function? Please provide tangible examples of commercial activity that can be hedged directly by the contracts or economic analysis that demonstrates the hedging utility of the contracts.
11. Should the Commission consider contract and position sizes, size of trade requirements, and/or an exchange's intended customer base to help assess whether a contract is likely to be used for hedging in at least some cases? Does the requirement that all contracts listed on Kalshi must be fully-collateralized affect this analysis? Does the requirement that these contracts trade in multiples of 5000 and/or the position limits applicable to the contracts affect the analysis of the hedging utility of the contracts?
12. Should the Commission consider the contract design and payout to help assess the hedging utility of the contract? For example, are binary contracts useful for hedging nonbinary economic events?
13. Do the contracts serve a price-basing function? For example, could they form the basis of pricing a commercial transaction in a physical commodity, financial asset, or service?
14. Are the contracts contrary to the public interest? Why or why not?
15. Could the trading of these or other political control or election-based contracts affect the integrity of elections or elections within a chamber of Congress? Could they affect the perception of the integrity of elections or elections within a chamber of Congress?
16. Could the contracts be used to influence perception of a political party or its candidates' likelihood of success? To this end, could the contracts be used to manipulate fundraising or voting?
17. Could the contracts facilitate violations of, or otherwise undermine, federal campaign finance laws or regulations? For example, could the contracts make it easier to sidestep prohibitions governing coordination between candidate campaign committees and political action committees?
18. Do the contracts present any special considerations with respect to susceptibility to manipulation or surveillance requirements?
19. What is the price forming information for these contracts while the contracts are trading? If the price forming information includes polling and other election prediction information, is that information regulated? How does the price forming information compare to informational sources (e.g. government issued crop forecasts, weather forecasts, federal government economic data, market derived supply and demand metrics

for commodities, market-based interest rate curves, etc.) that are generally used for pricing commodity derivative products within the Commission's jurisdiction?

20. Should, and if so how would, the registered entity listing the contracts take steps to address possible manipulative and/or false reporting activity involving the price forming information for the contracts, while the contracts are trading?
21. Do Kalshi's limitations on market participation affect the susceptibility of the contracts and/or markets for the contracts to manipulation? Do the limitations affect the extent to which these markets could be used to influence perception of a political party or candidate or otherwise be implicated in attempted election manipulation? Are the limitations reasonably enforceable?
22. Should the Commission be responsible for surveilling, and enforcing against, possible manipulative and/or false reporting activity involving the price forming information for the contracts, while the contracts are trading?
23. Could trading in the markets for the contracts obligate the Commission to investigate or otherwise become involved in the electoral process or political fundraising? If so, is this an appropriate role for the Commission?
24. What other factors should the Commission consider in determining whether these contracts are "contrary to the public interest?"

June 26, 2023

Secretary of the Commission
Office of the Secretariat
U.S. Commodity Futures Trading Commission Three Lafayette Centre
1155 21st Street, N.W. Washington, D.C. 20581
Dear Chairman and Commissioners of the Commodity Futures Trading Commission:

Introduction:

We are undergraduate researchers at Duke University focused on financial regulation whose areas of study include economics, mathematics, and computer science. In this letter, we hope to convince the Commission that they should not grant Kalshi approval to offer contracts related to partisan control of Congress. First and foremost, approving such contracts would contradict the Commission's prior treatment of similar contracts with respect to the North American Derivatives Exchange (Nadex) and PredictIt without suitable justification. Additionally, we believe that such contracts pose a net societal harm despite their alleged benefits. Kalshi and its supporters contend that such contracts would function as useful hedging instruments, yield more accurate election predictions through aggregating public opinion, and serve a price-basing role for real assets. On the other hand, critics of said contracts have argued their existence could expose retail traders to needless financial risk and, more importantly, create the risk of market manipulation that could weaken both election integrity and the perception of election integrity. In analyzing these potential costs and benefits, we hope to illustrate why rejecting Kalshi's proposal to offer such contracts, and more generally, why preventing any exchange from offering event contracts related to election results in the future, is consistent with the prior rulings of the Commission, in accordance with state and federal law, and clearly in the

public interest. In summary, while the alleged benefits of such contracts are spurious and marginal, the risks are both legitimate and significant.

Background:

Launched in 2021, Kalshi is a federally regulated exchange that offers binary “event contracts.”¹ These contracts allow users to purchase “yes” or “no” positions with regard to outcomes of particular events related to topics like the economy, climate, and public health.² Some of the exchange’s most popular recent contracts have concerned inflation data and the federal funds rate.³ In July 2022, Kalshi submitted a proposal to the Commission asking to list a set of contracts that would allow users to predict which political party would be in control of the Senate and House following the 2022 midterm elections.⁴ In the past, the Commission has been selective in permitting similar platforms to list political event contracts in acknowledgement of the potential risks inherent in allowing Americans to wager on election results.

In the early 1990s, the Commission provided Iowa Election Markets no-action relief to offer political event contracts under certain conditions.⁵ Iowa Election Markets had to remain strictly a not-for-profit, academic organization that sought to research “whether markets can aggregate information and predict outcomes more accurately than alternative technology such as

¹ Y-Combinator, “Kalshi: 1st Federally Regulated Exchange Where People Can Trade on Events,” <https://www.ycombinator.com/companies/kalshi>

² Alexander Osipovich, “Online-Trading Platform Will Let Investors Bet on Yes-or-No Questions,” *WSJ*, February 17, 2021, <https://www.wsj.com/articles/online-trading-platform-will-let-investors-bet-on-yes-or-no-questions-11613557800>.

³ *Ibid.*

⁴ Eliezer Mishory to the CFTC Secretary of the Commission, July 19, 2022, <https://www.cftc.gov/sites/default/files/filings/ptc/22/08/ptc082422kexdcm001.pdf>

⁵ Andrea M. Corcoran to George R. Neumann, June 18, 1993, <https://www.cftc.gov/sites/default/files/files/foia/repfoia/foirf0503b004.pdf>.

public opinion polling.”⁶ Additionally, the Commission prohibited any individual user from wagering more than \$500 and did not render an opinion on whether Iowa Election Markets violated any state laws.⁷ In late 2011, Nadex, a binary options exchange, submitted a proposal to the Commission seeking to offer political event contracts for the 2012 elections analogous to those Kalshi seeks to list for the 2022 midterms.⁸ The Commission rejected Nadex’s proposal, citing Section 5c of the Commodity Exchange Act (CEA) and two Commission Regulation clauses.⁹ Specifically, the agency explained that numerous state statutes consider trading political event contracts to be a form of gambling and that the Nadex contracts failed the economic purpose test in that they could not be employed as a hedging tool due to the “unpredictability of specific economic consequences of an election” and provided “no price basing utility” for real assets.¹⁰

In 2014, the Commission offered no-action relief to a platform called PredictIt, a joint-venture between Victoria University in New Zealand and American for-profit political technology company Aristotle.¹¹ Like Iowa Election Markets, PredictIt also vowed that the platform would be used primarily for academic research purposes and that its operators would receive no compensation.¹² Unlike Iowa Election Markets, the Commission allowed PredictIt to

⁶ Andrea M. Corcoran to George R. Neumann, June 18, 1993, <https://www.cftc.gov/sites/default/files/files/foia/repfoia/foirf0503b004.pdf>.

⁷ Jeff Sommer, “Forecasting the Future of Election Prediction Markets,” *NYT*, November 4, 2022, <https://www.nytimes.com/2022/11/04/business/electionprediction-markets-midterms.html>.

⁸ Timothy G. McDermott to David Stawick, December 19, 2011, <https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/documents/ifdocs/rul121911nadex002.pdf>.

⁹ Ben Protes, “Panel Rejects Proposal to Allow Election-Related Trading,” *NYT*, April 2, 2012, <https://archive.nytimes.com/dealbook.nytimes.com/2012/04/02/panetejects-proposal-to-allow-election-related-trading/>.

¹⁰ David Stawick, “Order Prohibiting the Listing or Trading of Political Event Contracts,” April 2, 2012, <https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/documents/ifdocs/nadexorder040212.pdf>.

¹¹ Sommer, *NYT*, <https://www.nytimes.com/2022/11/04/business/election-prediction-markets-midterms.html>.

¹² Vincent McGonagle to Neil Quigley, October 29, 2014, <https://www.cftc.gov/PressRoom/PressReleases/7047-14>.

offer a higher cap on maximum wagers, increase the number of investors allowed on the platform, and advertise in a limited capacity.¹³ The Commission reasoned that these modifications from the Iowa Election Markets precedent would allow PredictIt to better serve its academic function yet still prevent these contracts from harming the public interest.¹⁴ While Iowa Election Markets continues to operate under its no-action relief, the Commission revoked PredictIt's relief in August of 2022.¹⁵ The Commission has not commented specifically on how PredictIt violated the terms of their no-action letter; however, they reserve the right to revoke relief at their discretion.¹⁶

The Commission also recently took regulatory action against Polymarket, a crypto-based exchange that offers political event contracts.¹⁷ Polymarket offered "off-exchange" contracts, which means that they did not have designated contract market (DCM) status like Nadex or no-action relief like Iowa Election Markets and PredictIt. As a consequence, Polymarket was forced to pay a \$1.4 million fine.¹⁸ Polymarket, however, continues to offer event contracts related to the midterm elections to international users.¹⁹ InTrade, an Ireland-based trading exchange, tried to offer similar off-exchange contracts to American traders before the Commission sued them in 2012.²⁰ Even though for-profit exchanges have not been allowed to offer political event contracts

¹³ Ibid.

¹⁴ Ibid.

¹⁵ Vincent McGonagle to Margaret Hyland, August 4, 2022, <https://www.cftc.gov/PressRoom/PressReleases/8567-22>.

¹⁶ Neal E. Kumar, Serge B. Agbre, and Alexandra K. Calabro, "CFTC Staff Pull Longstanding No-Action Relief for Event Market PredictIt," Wilkie, Farr, & Gallagher LLP, August 15, 2022, <https://www.willkie.com/-/media/files/publications/2022/cftcstaffpulllongstandingnoactionreliefforeventmar.pdf>

¹⁷ CFTC, "Release Number 8478-22: CFTC Orders Event-Based Binary Options Markets Operator to Pay \$1.4 Million Penalty," January 3, 2022, <https://www.cftc.gov/PressRoom/PressReleases/8478-22>.

¹⁸ Ibid.

¹⁹ Ryan Deffenbaugh, "Prediction markets are facing a key test," *Protocol*, October 17, 2022, <https://www.protocol.com/newsletters/protocol-fintech/kalshi-cftc-election-markets>.

²⁰ CFTC, "Release Number 6423-12: CFTC Charges Ireland-based "Prediction Market" Proprietors Intrade and TEN with Violating the CFTC's Off-Exchange Options Trading Ban and Filing False Forms with the CFTC," November 26, 2012, <https://www.cftc.gov/PressRoom/PressReleases/6423-12>.

to American traders, established markets for betting on American elections exist in Europe—particularly in the United Kingdom and Ireland.²¹

Thus far, Kalshi has abided by all applicable regulations. They have registered as a DCM through the CFTC, partnered with a registered affiliate derivatives clearinghouse organization (DCO), and sought and received proper approval for all the contracts they currently list.²² One point of note is that Kalshi’s DCO, LedgerX LLC, is a subsidiary of FTX US Derivatives.²³ In response to FTX’s primary business unit, FTX Trading Ltd., filing for bankruptcy, Kalshi reassured its customers in an open letter that their funds were safe.²⁴ LedgerX was only authorized to clear fully-collateralized futures, options on futures, and swaps, and Kalshi users are not permitted to trade on leverage; however, because there are still a great deal of unknowns regarding the FTX collapse, there is reason to be wary of Kalshi’s relationship with the firm.²⁵

Regardless of LedgerX’s status, the Commission should reject Kalshi’s proposal, because it is not materially different from Nadex’s proposal, and because allowing such contracts would threaten the perception of the United States’ election integrity. The arguments Kalshi advances with regard to these contracts’ hedging utility, predictive power, and price-basing function are not only weak but contradictory and dwarf in comparison to the imperative duty of public institutions to do what they can to strengthen election integrity and the perception of election integrity at a time when trust in our democratic processes is concerningly fragile.

²¹ Divya Chowdhury and Aaron Saldanha, “Betting markets expect U.S. election result by Wednesday,” *Reuters*, November 2, 2020, <https://www.reuters.com/article/usa-election-gambling-gmf/betting-markets-expect-u-s-election-result-by-wednesday-idUSL4N2HO37M>.

²² CFTC, “Release Number 8302-20: CFTC Designates KalshiEX LLC as a Contract Market,” November 4, 2020, <https://www.cftc.gov/PressRoom/PressReleases/8302-20>.

²³ Kalshi, “Kalshi and LedgerX advance to next step of launching new event contracts exchange,” September 8, 2020, <https://kalshi.com/blog/kalshi-ledger-partnership>.

²⁴ Kalshi, “Kalshi Customer Funds are Safeguarded in Segregated Accounts,” November 11, 2022, <https://kalshi.com/blog/kalshi-customers-are-safeguarded>.

²⁵ LedgerX, “Overview,” <https://ledgerx.com/clearing>.

Analysis:**Hedging:**

In examining the costs and benefits of allowing Kalshi users to trade binary options predicting the parties that would control the House and Senate following the midterms, we concluded that, while the benefits are tenuous and only accrue to a limited number of citizens, the potential risks are severe and could impact American society at large. According to the Commodity Exchange Act, the Commission is called to put proposed contracts to an economic purpose test to determine whether their existence would provide any hedging or price-basing utility.²⁶ Specifically, the Commission raises the question (6) of whether or not the economic consequences of a party controlling Congress are predictable enough to allow these contracts to serve a useful hedging function.²⁷ In rejecting Nadex's proposal in 2012, the Commission reasoned that there was too tenuous a connection between election results and specific economic consequences that could be hedged against.²⁸ In this sense, we see no good reason to believe that the Commission's argument here was flawed or that the relationship between election results and economic effects has changed.

For example, if a restaurant wanted to hedge against an expected change in the small business tax code that a particular party has indicated they would enact, Kalshi's contract would not offer as direct and robust a hedge as would, for instance, a bet against the price of beef increasing. In the latter case, the restaurant can definitively protect themselves against increases

²⁶ Commodity Exchange Act, 7 U.S.C. § 1, United States Code, <https://www.law.cornell.edu/uscode/text/7/chapter-1>.

²⁷ CFTC, "Questions on the KalshiEX, LLC "Will <party> be in control of the <chamber of Congress>?" Contracts for Public Comment," <https://www.cftc.gov/sites/default/files/filings/documents/2022/orgkexpublicquestions220829.pdf>.

²⁸ Stawick, "Prohibiting Political Event Contracts," <https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/documents/ifdocs/nadexorder040212.pdf>.

in the price of beef by purchasing cattle options that they can redeem if prices increase. In the former case, there are countless scenarios where the party that the restaurant bets on loses yet the tax change is still enacted. Perhaps, the winning party compromises with the losing party, allowing them to enact the tax change in exchange for concessions on what they deem to be a more important piece of legislation. In this example, the restaurant would have not only lost the bet on Kalshi's election contract, but it would also have been forced to pay the higher taxes. Depending on the magnitude of their hedge, the results could be disastrous for a small business. A more concrete example relates to student loans. In the 2020 election cycle, Democrats made it clear that they hoped to forgive student loan debt; however, even after President Biden used executive action to forgive \$10,000 of federal student loans per person, the constitutionality of his move is currently being challenged in the courts.²⁹ As such, a student who bet on President Trump winning the 2020 in order to hedge against their student loan debt not being forgiven would have lost the wager and also would have been forced to pay back their student loans. Accordingly, these examples illustrate that political events contracts are a poor hedging instrument and suggest that the flawed portrayal of political event contracts as adequate hedging tools could put retail investors at risk of financial harm.

In another submitted comment letter, NYU law professor Max Raskin argues in defense of these contracts as a useful means of hedging.³⁰ He is correct in stating that individuals often hedge against downside risks without being absolutely certain of the hedge's success.³¹ However, the probability that an individual can account for all the nuances of the U.S.' political

²⁹ Katie Lobosco, "What student loan borrowers need to know after a federal court struck down Biden's forgiveness program," *CNN*, <https://www.cnn.com/2022/11/10/politics/bidenstudent-loan-forgiveness-struck-down>.

³⁰ Max Raskin to the CFTC Secretary of the Commission, September 22, 2022, <https://comments.cftc.gov/PublicComments/CommentList.aspx?id=7311>

³¹ *Ibid.*

processes to predict that a piece of legislation will pass and to foresee the specific effect it will have on them given a party winning control of one house of Congress is nowhere near close to one hundred percent. While Professor Raskin believes that “congressional leaders make genuine attempts to enact the agendas they lobby for,” we are slightly less optimistic about the transparency and predictability of America's legislative processes and the willingness— let alone ability— of legislatures to enact their campaign promises.³² By calculating a weighted-average from eleven academic studies, FiveThirtyEight estimates that presidents fail to keep roughly one-third of their campaign promises.³³

Insurance:

Kalshi claims that its exchange can be used as a form of insurance, but Kalshi is indisputably inferior to existing insurance in its ability to protect against future losses.³⁴ In an interview with Yahoo Finance, Tarek Mansour, a co-founder of Kalshi, claims that election betting and similar trades function as a transparently exchanged form of insurance.³⁵ More specifically, according to their website, Kalshi has advantages over traditional insurance due to its umbrella coverage, next day payouts, granular control, and lack of claims adjusters.³⁶ Though it is true that Kalshi allows investors to bet on specific events that may not otherwise be covered under insurance, such as election outcomes, these events are not direct indicators of loss or gain, and are therefore unreliable. Car insurance, for instance, can help cover the cost of a car crash in the event that it occurs; this form of insurance is directly contingent upon the presumed loss

³² Raskin, <https://comments.cftc.gov/PublicComments/CommentList.aspx?id=7311>

³³ Timothy Hill, “Trust Us: Politicians Keep Most of Their Promises,” 538, April 21, 2016, <https://fivethirtyeight.com/features/trust-us-politicians-keep-most-of-their-promises/>.

³⁴ Yahoo Finance, *Yahoo Finance*, March 15, 2022.

³⁵ *Ibid.*

³⁶ “Hedge on Your Terms,” Kalshi, 2022, <https://kalshi.com/hedging>.

occurring. On the other hand, if a trucking business believes gas prices are tied to a particular congressional majority, they may try to protect themselves from the potential losses derived from gas price increases by betting on Democrats holding a congressional. While the policies politicians or political parties endorse may impact gas prices, no individual politician or party can unilaterally raise or lower gas prices. Rather than insuring one's business, one can only insure against a tangentially related factor, thus making this form of "insurance" far riskier than its traditional counterpart. Since Kalshi only hosts \$1 binary contracts, one can only truly bet on whether something will occur, but not on the extent of the occurrence. For example, one may bet that gas prices will increase, but they cannot bet on the amount by which they will increase, thus limiting Kalshi's ability to specifically insure against downside risks. Furthermore, while next day payouts may be advantageous, they may attract people who are in need of a payout quickly, thus making Kalshi more akin to gambling than an efficient insurance mechanism. In terms of granular control, which Kalshi describes as the ability to choose exactly how much money to bet and the option to cancel early to minimize losses, it is true that bettors may benefit from deciding how much to bet on a given event. However, this means bettors assume extra risk compared to insurance; while insurance rates are determined by underwriters using a number of variables, it is up to the individual to determine how much to invest in a given contract. Additionally, while bettors can cancel their orders before trades are made and close out their position by essentially buying contracts opposite to the direction of those that one wishes to cancel, it is not possible to cancel a trade. Therefore, Kalshi's cancellation ability is inferior to that of insurance policies, which can be canceled when one decides they do not want insurance anymore. Finally, the proposed benefit of not needing claims adjusters is not so much a benefit as it is a product of Kalshi not offering bets on getting into a car crash, for instance. Kalshi's insurance function is

more akin to speculation and gambling than it is to insurance against real-world risk. Overall, investors may have more flexibility through Kalshi than through traditional insurance, but they are not protected by insurance regulators or by the guarantee that they will be insured against the loss against which they are betting.

Price-Basing Utility:

In response to another one of the Commission's questions (11), political event contracts fail to serve any real price-basing utility for the same reasons that they are an inadequate tool for hedging.³⁷ In the Commission's Nadex decision, they argued that "there is no situation in which the Political Event Contracts' prices could form the basis for the pricing of commercial transactions."³⁸ We see no reason to overturn the Commission's reasoning as the economic ramifications of an election are indirect and opaque – as discussed with regard to hedging – which implies that the price of election markets does not help determine the price of any physical or financial asset in a predictable manner. Some commenters have attempted to argue otherwise. The CIO of Sharp Square Capital, Filip Pidot, argues that decisions such as whether two companies should merge or not are affected by congressional majorities.³⁹⁴⁰ Here, Pidot makes a correct, yet weak, assertion that which party controls Congress will affect a corporate merger. A complex endeavor such as a corporate merger will obviously be impacted by which party controls Congress as they would presumably pass different laws and appoint different personnel

³⁷ CFTC, "Questions on KalshiEX,"

<https://www.cftc.gov/sites/default/files/filings/documents/2022/orgkxpublicquestions220829.pdf>

³⁸ Stawick, "Prohibiting Political Event Contracts,"

<https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/documents/ifdocs/nadexorder040212.pdf>.

³⁹ Flip Pidot to the CFTC, September 2, 2022,

<https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69645&SearchText=>

⁴⁰ Notably, Sharp Square Capital describes themselves as a "alternative investment management firm specializing in event futures on @kalshi."

to regulatory agencies that oversee mergers. However, the more pertinent question is what impact congressional control would have on the price of mergers. If a merger concerned a solar panel company, it is easy in hindsight to say that the Democrats 2020 congressional majority would increase its price because of the green tax credits that were ultimately included in the Inflation Reduction Act (IRA).⁴¹ But, as shown through the example of student debt relief, not all campaign promises are kept. In this way, it is easy to say that a midterm election will affect the prices of companies, but it would be highly spurious to say that one can make meaningful inferences regarding the price of a company from the prices of election markets.

Gaming:

In their rejection of Nadex's proposal, the Commission explained that "a federal statute defines the term 'bet or wager' as 'the staking or risking by any person of something of value upon the outcome of a contest of others.'"⁴² The Commission specified that even though political event contracts on congressional majorities are only premised indirectly upon "the outcome of a contest between electoral candidates" they still defined the act of participating in Nadex's proposed markets as "betting" or "wagering."⁴³ In this way, Nadex's proposed markets would be considered gambling in several states where state statutes either define gambling in part as an act that involves "wagering" and "betting" or directly reference election wagering in their gambling definitions.⁴⁴ The only material difference between Nadex's proposal and Kalshi's is that Nadex

⁴¹ Francesca Paris, Alicia Parlapiono, Margot Sanger-Katz, and Eve Washington, "A Detailed Picture of What's in the Democrats' Climate and Health Bill," *NYT*, August 16, 2022, <https://www.nytimes.com/interactive/2022/08/13/upshot/whats-in-the-democrats-climate-health-bill.html>.

⁴² Stawick, "Prohibiting Political Event Contracts," <https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/documents/ifdocs/nadexorder040212.pdf>.

⁴³ *Ibid.*

⁴⁴ *Ibid.*

wanted to also list a contract relating to the Presidential election.⁴⁵ Thus, in response to the Commission's first question (1), we believe that Kalshi's proposed contracts do reference "gaming" as defined in Commission regulation 40.11 (a)(1) and 5c(c)(5)(C) of the Commodity Exchange Act.⁴⁶ Additionally, in response to the Commission's second (2) and third (3) questions, we believe that the Commission must consider whether taking a position on which party will win a congressional majority is illegal under state gambling laws.⁴⁷ Although Kalshi maintains that their platform is for trading and not gambling, political gambling is banned at the federal level.⁴⁸ In this way, we urge the Commission to consider what would distinguish trading on Kalshi's political event contracts from gambling.

Predictive Power:

There is a long history of political betting in the United States, legal, or, in many cases, illegal. Before the rise of scientific polling, the political betting market functioned well as a predictor of elections at both the state and the national level.⁴⁹ Election betting consisted of standardized contracts that employed fixed dollar payments if a particular candidate won office; typically, so-called betting commissioners offered these contracts, held the stakes of both parties, and took a five percent commission on winnings.⁵⁰ In the 1880s, betting markets moved from poolrooms to the Curb Exchange and Broadway hotels, and in the 1920s and 1930s, specialist

⁴⁵ Ibid.

⁴⁶ CFTC, "Questions on KalshiEX," <https://www.cftc.gov/sites/default/files/filings/documents/2022/orgkexpubquestions220829.pdf>

⁴⁷ Ibid.

⁴⁸ Rick Maese, "Political Betting Is Surging. The Forecast Is about to Get Complicated." *The Washington Post*, November 2, 2022, <https://www.washingtonpost.com/sports/2022/11/02/politicalbetting/>.

⁴⁹ Paul W Rhode and Koleman S Strumpf, "Historical Presidential Betting Markets," *Journal of Economic Perspectives* 18, no. 2 (2004): pp. 127-142, <https://doi.org/10.1257/0895330041371277>

⁵⁰ Ibid.

firms comprised of betting commissioners emerged.⁵¹ In the 1896, 1899, 1904, 1916, and 1924 elections, three newspapers, including the *New York Times*, provided almost-daily price quotations on different candidates' odds, and the average betting volume was over two hundred times the maximum amount wagered in any Iowa Election Market, with over \$165 million in 2002 dollars bet in the 1916 election.⁵² However, after 1940, and concurrently with the rise of scientific polling – which was a substitute for betting odds free from the moral objections against gambling – and laws addressing moral hazard, election tampering, information withholding, and strategic manipulation, there was a significant reduction in betting activity.⁵³ Thus, while there is not much legal precedence for election betting, there is cultural precedence, and the data does suggest fair markets may work well as election indicators.

One of the main reasons Kalshi and its supporters believe political event contracts are beneficial is that they may serve as more accurate indicators of political outcomes than polling. Kalshi claims its markets host “the most accurate predictions in the industry.”⁵⁴ It is unclear if Kalshi is referring to the political betting industry – which, given the Commission’s history of eliminating participating parties, is a very small industry, at least domestically – or to the election prediction industry in general; in either case, Kalshi does not provide any evidence to support this claim. Writing in support of Kalshi, Dr. Jason Furman, the Former Deputy Director of the National Economic Council, claims that political betting markets provide important information regarding political outcomes.⁵⁵ Specifically, he argues that the White House,

⁵¹ Ibid.

⁵² Ibid.

⁵³ Ibid.

⁵⁴ “Forecasting,” Kalshi, 2022, <https://kalshi.com/forecasting>.

⁵⁵ Jason Furman to the CFTC Secretary of the Commission, September 18, 2022, <https://comments.cftc.gov/PublicComments/ViewComment.aspx?ID=69708&GUID=264324ae75cb-4c97-9d45-62baa1877335>.

economic researchers, and educators rely upon these markets in their work.⁵⁶ However, the assertion that political betting markets are accurate indicators of election outcomes relies upon the assumption that those engaged in the market are trading based on the outcomes they expect. In this way, Kalshi's argument that their political event contracts would serve as a hedging instrument contradicts their argument that their contracts would help predict election results. For instance, if someone thinks the Republicans will win the Senate, they may still bet on the Democrats winning to hedge against the perceived risk – in their opinion – that Democratic policies will increase their taxes, thus skewing the markets away from an accurate depiction of public opinion. Here, a trader using these political event contracts to hedge risk will bet not on the party they believe will win, but instead on the party they believe will expose them to some financial risk should they win. Even if only a fraction of Kalshi's users intend to use political event contracts to hedge, they would limit the ability of these contracts to provide accurate predictions. If Kalshi provided data concerning the breakdown of users and their primary goals with Kalshi, whether hedging or prediction outcomes, then it would be easier to analyze its efficacy as an election predictor. Accordingly, even though Kalshi's political event contracts are ineffective hedging instruments, the mere fact that Kalshi projects these contracts are effective hedging tools is good reason to believe that at least some traders will use them as such, thereby limiting the contracts' aggregated predictive power.

Market Manipulation:

Kalshi's political event contracts could also be vulnerable to market manipulation that would impact their efficacy as predictors. As Better Markets argues in their comment letter,

⁵⁶ Ibid.

parties privy to non-public information – such as campaign finance data and internal polling – may profit off of their knowledge.⁵⁷ Professor Rebecca Haw Allensworth notes in a 2009 Harvard Law Review article that, in 2004, an Ireland-based exchange called TradeSports offered an election market that experienced two “sustained attempts” of market manipulation.⁵⁸ In this regard, Better Markets argues that Kalshi has not offered – or at least disclosed to the public – any explanation for how they would combat such manipulation.⁵⁹ Allowing Kalshi to list these contracts without confirming that these markets would not be “readily subject to manipulation” would violate the Commission’s Core Principle Three requirement.⁶⁰ For example, trading syndicates could artificially lower the price of contracts and buy shares to sell for a profit once prices rise, or they could purchase shares at an elevated price to lead others to believe a given candidate is more likely to win.⁶¹

In the long run, Kalshi hopes to rival exchanges like the New York Stock Exchange and CME Group.⁶² While they currently have a downside limit for \$25,000 for individual contracts, Kalshi plans on increasing this limit.⁶³ As it stands now, this \$25,000 limit already exceeds the \$850 investment limit the Commission set for PredictIt in their 2014 no action letter.⁶⁴ Further increasing their limit would help Kalshi attract institutional investors – something executives

⁵⁷ Better Markets to the CFTC Secretary of the Commission, September 25, 2022, https://bettermarkets.org/wp-content/uploads/2022/09/Better_Markets_Comment_Letter_KalshiEX.pdf

⁵⁸ Rebecca Haw Allensworth, “Prediction Markets and Law: A Skeptical Account,” 122 HARV. L. REV. 1217 (2009).

⁵⁹ Better Markets to the CFTC, https://bettermarkets.org/wp-content/uploads/2022/09/Better_Markets_Comment_Letter_KalshiEX.pdf

⁶⁰ *Ibid.*

⁶¹ *Ibid.*

⁶² Ryan Deffenbaugh, “Election Markets Are Far from a Sure Bet,” *Protocol*, October 6, 2022.

⁶³ Jesse Pound, “This New Exchange Lets Investors Vote Yes or No on Major Events to Hedge Their Portfolios,” *CNBC*, December 29, 2021, <https://www.cnn.com/2021/12/29/thisnew-exchange-lets-investors-vote-yes-or-no-on-major-events-to-hedge-their-portfolios.html>.

⁶⁴ CFTC Director of the Division of Market Oversight Vincent McGonagle to Neil Quigley of the Victoria University of Wellington, October 29, 2014, <https://www.cftc.gov/PressRoom/PressReleases/7047-14>.

have also touted as a goal.⁶⁵ That being said, such increases would only make it easier for wealthy traders or syndicates to manipulate election markets. The vulnerability of these political event contract markets to manipulation not only detracts from the legitimacy of them as predictors of election outcomes, but it also opens elections themselves up to potential manipulation.

Election Integrity:

In the United States, voter turnout is approximately sixty percent in presidential elections and forty percent in midterm elections.⁶⁶ In a recent ABC/Ipsos poll, only twenty percent of the public reported feeling “very confident” about the election system,⁶⁷ and fifty-six percent of Americans reported having little or no confidence that American elections represent the will of the people.⁶⁸ Following the January 6th attack on the United States Capitol and the perpetuation of President Trump’s election lies, bolstering rather than weakening our elections should be of paramount importance. If Americans believe that Kalshi’s election markets are accurate predictors of election outcomes – as Kalshi contends – these markets could affect voter turnout. Dr. Leonardo Bursztyn, a University of Chicago economist, identified “a causal effect of anticipated election closeness on voter turnout in Swiss referenda” across cantons where polling estimates differed.⁶⁹ In his paper, Bursztyn demonstrates that cantons where polling indicated

⁶⁵ Segal, “MIT Grads Were Interns at Goldman and Citadel,” <https://www.institutionalinvestor.com/article/b1t43r4w6x4z3x/These-MIT-Grads-Were-Interns-at-Goldman-and-Citadel-Now-They-Want-to-Democratize-Hedging>.

⁶⁶ “Voter Turnout.” FairVote, October 17, 2022. <https://fairvote.org/resources/voter-turnout/>.

⁶⁷ Brittany Shepherd, “Americans’ Faith in Election Integrity Drops: POLL,” *ABC News*, January 6, 2022, <https://abcnews.go.com/Politics/americans-faith-election-integrity-drops-poll/story?id=82069876>.

⁶⁸ Jennifer Agiesta, “CNN Poll: A Growing Number of People Lack Confidence in American Elections,” *CNN*, February 11, 2022, <https://www.cnn.com/2022/02/10/politics/cnnpoll-democracy/index.html>.

⁶⁹ Leonardo Bursztyn, Davide Cantoni, Patricia Funk, and Noam Yuchtman, “Polls, the Press, the Political Participation: The Effects of Anticipated Election Closeness on Voter Turnout,” July 2018, https://faculty.haas.berkeley.edu/yuchtman/Noam_Yuchtman_files/close_polls.pdf.

close outcomes experienced greater voter turnout than cantons where polling indicated landslide outcomes, all else equal.⁷⁰ Although the research on this relationship is limited because economists have struggled to find suitable natural experiments, Bursztyrn extrapolates that anticipated election closeness could have played a role in the 2016 U.S. Presidential election.⁷¹ Here, he explains that conservative leaning sources, which he argues Republicans are more likely to see, predicted much closer election outcomes than non-partisan and left leaning sources, which could have incentivized Republican voter turnout.⁷² In this sense, foreign adversaries could work to manipulate Kalshi's election markets by overwhelming them with a huge influx of trades to distort the public's expectation of election closeness and potentially negatively affect voter turnout. Even if one believes that foreign adversaries or any other mal-intentioned domestic groups will not attempt to manipulate Kalshi's elections markets and that perceived election closeness has no real causal impact on voter turnout, the existence of such risks could harm the perception of election integrity.

The Perception of Election Integrity:

While some might feel that protecting the perception of election integrity is a subordinate concern beneath protecting election integrity, the 2020 Presidential election and its subsequent controversy demonstrated that protecting the perception of election integrity is just as important as protecting election integrity with regard to defending our democracy. Further, although we have explained why we believe Kalshi's election markets would not provide accurate predictors of election outcomes as the company believes, the effect Kalshi's markets have on voter

⁷⁰ Ibid, 5.

⁷¹ Ibid, 22.

⁷² Ibid, 22.

behavior depends on how the public perceives their predictive accuracy. For example, if President Trump had been predicted to win the 2020 election based on the manipulation or inaccuracy of Kalshi's market, he and his supporters could have used this fact as evidence to support their fraudulent claims of election corruption.

Thus, in response to the Commission's twelfth question (12), we believe these contracts would harm the public interest through the impact they could have on the perception of election integrity. Trust in civil institutions represents the bedrock of democracy and sound public governance. The foundation of a healthy democracy has historically been rooted in trust, yet today, two-thirds of Americans have little to no confidence in the federal government.⁷³ Many ascribe this fading trust to a political culture and media landscape riddled with misinformation, and Kalshi's election markets would provide those who wish to sow division in this country yet another means to potentially manipulate the public perception surrounding election integrity. Accordingly, we urge the Commission to consider how election lies have poisoned our public discourse as a glaring demonstration of the impact that perceived flaws in election integrity can have on our country. Allowing Kalshi to list these contracts will hinder efforts to rebuild trust in our elections and increase the likelihood that election misinformation will have an impact on the public's acceptance of the 2024 presidential election results.

Conclusion:

To reiterate, we strongly believe the best approach for the Commission to take is to ban Kalshi from offering event contracts that would permit trading on whether Democrats or Republicans will take control over each chamber of Congress after the midterm elections. These

⁷³ Rosenberg, Stacy. "Trust and Distrust in America." Pew Research Center - U.S. Politics & Policy. Pew Research Center, July 27, 2021. <https://www.pewresearch.org/politics/2019/07/22/trust-and-distrust-in-america/>.

contracts are flawed hedging tools because of the unpredictable relationship between election results and subsequent economic consequences. With regard to these contracts' price-basing function, there is no good reason to question the Commission's verdict in 2014 that they serve no such function. Further analysis of the Nadex decision reveals that Kalshi's proposed contracts do in fact reference "gaming," and thus, may be considered gambling, in which case they would be illegal in several states.⁷⁴ Although there is some evidence supporting the predictive power of political markets, Kalshi's emphasis on hedging and their failure to explain how they plan to prevent market manipulation undermine their claim that their markets would have meaningful predictive power. The potential positive causal relationship between the anticipated closeness of elections and voter turnout increases the importance of addressing the market manipulation risks and demonstrates how manipulating political markets could influence election integrity. Even if actual market manipulation did not occur, the mere potential for such manipulation to occur weakens the perception of election integrity. Accordingly, the recency of the January 6th insurrection should serve as a stern reminder that if the public – or a part of the public – perceives elections to be corrupt, political violence can ensue. Rather than democratizing finance, as Kalshi hopes, these political event contracts may instead finance threats to democracy. The marginal benefit of allowing an election market that may produce better predictions cannot justify these outsized risks to the public interest, and specifically, to our democracy – at a time when bolstering trust in our civil institutions must be of the utmost importance. Thus, we urge the Commission to deny Kalshi's proposal to list contracts related to partisan control of Congress and to remain steadfast in their commitment to not allowing for-profit companies to create political trading markets.

⁷⁴ CFTC, "Questions on the KalshiEX," <https://www.cftc.gov/sites/default/files/filings/documents/2022/orgkexpublicquestions220829.pdf>

Sincerely,

Laura Boyle, Thomas Colicchio, and Morgan Joseph

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July 20, 2023

Chairman Rostin Behnam
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, D.C. 20581

RE: Public Citizen response to the request for comment on the proposed gaming contract of KalshiEX that would authorize gambling on election outcomes (Release No. 8728-23)

Dear Chairman Behnam and Commissioners:

Public Citizen is writing to express firm opposition to the contract proposal by KalshiEX, LLC (Kalshi) to allow the firm to run organized and large-scale gambling on election outcomes, in this particular case, betting on partisan control of Congress. Such a government-authorized contract would explicitly run afoul of Commission regulation 40.11(a)(1) and Section 5c(c)(5)(C) of the Commodity Exchange Act that prohibits contracts “contrary to the public interest,” such as those involving injurious gaming practices.

In fact, we are stunned that the Commodity Futures Trading Commission (CFTC) is even considering approval of such a gaming contract that will likely damage both the appearance and the practice of the integrity of American elections.

Public Citizen is a nonprofit consumer advocacy organization that champions the public interest in the halls of power. We defend democracy and fight to ensure that government works for the people – not big corporations. Founded in 1971, we now have 500,000 members and supporters throughout the country.

As a public interest organization dedicated to strengthening the American democracy – and the integrity of elections, in particular, as well as one focused on protecting the markets and financial systems to benefit regular consumers – Public Citizen encourages the CFTC not to provide government sanction for gambling on elections.

COMMENT: ELECTIONS SHOULD NOT BE JUST ABOUT MONEY

The integrity of elections is the cornerstone of a healthy democracy. When the integrity of elections is tainted in appearance or in actuality, democracy itself is threatened. The Kalshi

contract proposal poses precisely such a threat by seeking government sanction of sports betting on election outcomes.

While little can be done about individuals betting on election outcomes in their personal capacity – even though it is illegal at the federal level and in all states – if the CFTC provides its official endorsement of such wagering, the practice is very likely to spread across the nation. The states and the CFTC have appropriately banned gambling on election outcomes through most of American history. Political wagering was briefly allowed in West Virginia in 2020, for about one hour, before the state reversed course and shut it down.¹

The Commodity Futures Trading Commission has generally followed suit. Economists at Victoria University of Wellington in New Zealand requested approval of such gambling from the CFTC in 2014. A couple of years before, the Commission rejected a similar request from Nadex to offer political-event contracts, ruling that such contracts met a federal definition of gambling: “the staking or risking by any person of something of value upon the outcome of a contest of others.”² In 2013, the CFTC had effectively shut down Intrade, an Ireland-based exchange that had accepted millions of dollars in bets on U.S. elections.

But there was a small, noncommercial exception to this rule: the University of Iowa, with permission from the CFTC, had overseen the Iowa Electronic Markets—which accept trades from students and faculty on participating campuses—since 1993. Victoria University proposed expanding on the Iowa model. The CFTC replied that “an academic exercise demonstrating the information gathering and predictive capabilities of markets” would be allowed, so long as Victoria didn’t profit from it. The betting pool was named PredictIt. But the Commission reversed course and shut the pool down after it became evident that PredictIt started reaping huge profits rather than serving just as an academic experiment.³

Shortly after, the CFTC made another surprise announcement in opening up a comment period to consider this Kalshi proposal. Kalshi would allow traders to invest up to \$25,000 on a given political contract, well beyond what PredictIt was allowed to accept.

The Kalshi proposal should also not be allowed to stand. First of all, gambling on election outcomes is fraught with deceptive manipulation and, secondly, can cast a pall over the integrity of elections. In 2012, for example, a high-profile incident involving the prediction market Intrade showed how election wagering can be manipulative, called the “Romney Whale.” In the lead up to the final election contest between Barack Obama and Mitt Romney, the Intrade betting pool led many observers to believe Romney was favored to win. Upon closer investigation,

¹ Anthony Izaguirre, “Presidential betting gets axed quickly in West Virginia,” *Associated Press* (April 8, 2020), available at: <https://apnews.com/article/3748c12d07fefedc6fbdf6478842a782>

² Danny Funt, “Betting on elections can tell us a lot. Why is it still mostly illegal?” *New Yorker* (Nov. 2, 2022), available at: <https://www.newyorker.com/news/the-political-scene/betting-on-elections-can-tell-us-a-lot-why-is-it-mostly-illegal>

³ *Id.*

it turned out that a single bettor placed large sums of money to falsely prop up Romney as the likely victor.⁴

Furthermore, wealthy special interests who have large sums of money riding on election outcomes are going to be motivated to affect those outcomes through whatever means are available. This could include pouring more money into outside electioneering groups, such as super PACs, or intimidating election officials and poll workers, or even denying unfavorable election results.

Worse yet, placing large sums of money on the outcome of elections will likely fuel the public perception that elections are all about money rather than an expression of the popular will. Public confidence in the integrity of elections is already at an all-time low. Most Americans lack confidence that the results of American elections reflect the will of the people, a sentiment that has grown steadily since January 2021. And nearly half of Americans polled say they think it is at least somewhat likely that in the next few years, some elected officials will successfully overturn the results of an election because their party did not win.⁵

Turning elections into a financial game for the wealthy will further add to suspicions as to whose interests elections represent. Not only would election results be influenced by wealthy special interests funding campaigns, but those same special interests would then have a very compelling reason to secure self-serving results. The consequences of gambling on elections are far-reaching and alarming. Given the abuses of social media in both the gambling and political spaces, allowing gambling on elections will incentivize more interference and misconduct as gamblers seek to shape political outcomes for financial profit. The public perception that money buys elections would be vastly magnified.

CONCLUSION: THE COMMODITY FUTURES TRADING COMMISSION SHOULD NOT SANCTION GAMBLING ON ELECTIONS

The Commission got it right the first time: gambling and elections are a bad mix that runs contrary to the public interest. There is good reason that federal, state and local governments have long banned betting on elections. The CFTC should continue standing for election integrity and not allow itself to be used as back-door entry for the gaming industry to profit from politics.

Election gaming serves no useful function other than to generate a profit for the few. In the meantime, election gaming can encourage manipulation of the electoral process and risks incentivizing a variety of means to affect election outcomes by those who stand to lose or gain large sums of money, from pouring additional funds into outside electioneering groups to intimidating election workers and perhaps even denying election results.

⁴ John Holden, "Why can't Americans bet legally on the US presidential election?" Legal Sports Report (Feb. 18, 2020), available at: <https://www.legalsportsreport.com/37949/2020-presidential-election-betting-us/>

⁵ Jennifer Agiesta, "CNN poll: Americans' confidence in elections has faded since January 6," CNN Politics (July 21, 2022), available at: <https://www.cnn.com/2022/07/21/politics/cnn-poll-elections/index.html>

Free and fair elections are an essential component of democratic governance. Transforming elections into what many could well perceive as a game for wealthy special interests undermines the democratic body politic.

Sincerely,

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July 21, 2023

Christopher Kirkpatrick, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581
<https://comments.cftc.gov/PublicComments/CommentList.aspx?id=7394>

Re: CFTC Review of KalshiEx Proposed Congressional Control Contracts
Under CFTC Regulation 40.11

Dear Mr. Kirkpatrick:

I am responding to the CFTC's Questions on the KalshiEX LLC ("Kalshi") "Will <chamber of Congress> be controlled by <party> for <term>?" Contracts for Public Comment ("CFTC 2023 Questions").¹ I respond despite signs that the CFTC has already made up its mind.

The Kalshi contracts are clearly not prohibited under the Commodity Exchange Act ("CEA") and CFTC regulations. These prohibit *an instrument* that has any involvement with, relationship to, or *reference* a defined set of listed activities. The prohibition is not whether people can make an illegal bet on an outcome- for example who will win an election or whether the price of wheat will increase- but whether *the instrument "involves, relates to, or references"* activities listed by the CFTC in Rule 40.11 as against the public interest. These listed activities are "terrorism, assassination, war, gaming, or an activity that is unlawful under any State or Federal law" or "an activity that *is similar ... and* that the Commission determines, by rule or regulation, to be contrary to the public interest." "Elections" is not in this list, and elections are not "similar" to terrorism, assassination, war, gaming, or an activity that is unlawful under any state and federal law.

Part One

The CEA defines "event contracts" as "an occurrence, extent of an occurrence, or contingency (other than a change in the price, rate, value, or level of a commodity not

¹ CFTC, Release No. 8728-23, *CFTC Announces Review of Kalshi Congressional Control Contracts and Public Comment Period*, Jun. 23, 2023, avail. at <https://www.cftc.gov/PressRoom/PressReleases/8728-23>.

described [here]) that is (I) beyond the control of the parties to the relevant contract ...; and (II) associated with a financial, commercial, or economic consequence.”² In 2008, the CFTC explained, “event contracts may be based on eventualities and measures as varied as the world’s population in the year 2050, the results of political elections, or the outcome of particular entertainment events. ... Event contracts have been based on ... the accomplishment of certain scientific advances, ... the adoption of particular pieces of legislation, the outcome of corporate product sales, the declaration of war and the length of celebrity marriages.”³

In 2010, §745 of the Dodd-Frank Act added §5c(c)(5)(C) to the CEA:

Special Rule For Review And Approval Of Event Contracts And Swaps Contracts.— (i) Event Contracts.—In connection with the listing of agreements, contracts, transactions, or swaps in excluded commodities that are based upon the occurrence, extent of an occurrence, or contingency (other than a change in the price, rate, value, or levels of a commodity described in section 1a(2)(i)), by a designated contract market or swap execution facility, the Commission may determine that such agreements, contracts, or transactions are contrary to the public interest if the agreements, contracts, or transactions involve— (I) activity that is unlawful under any Federal or State law; (II) terrorism; (III) assassination; (IV) war; (V) gaming; or (VI) *other similar activity* determined by the Commission, by rule or regulation, to be contrary to the public interest. (ii) Prohibition.—No agreement, contract, or transaction determined by the Commission to be contrary to the public interest under clause (i) may be listed or made available for clearing or trading on or through a registered entity. ...⁴

The law provides that the CFTC “may determine” that “such” event contracts are “contrary to the public interest” for one of six listed reasons, and if the CFTC does so, “such” event contracts are prohibited. A year later the CFTC promulgated Rule 40.11:⁵

Review of event contracts based upon certain excluded commodities. (a) Prohibition. A registered entity *shall not list for trading or accept for clearing* on or through the registered entity any of the following: (1) An agreement, contract, transaction, or swap based upon an excluded commodity, as defined in Section 1a(19)(iv) of the Act,⁶ that *involves, relates to, or references terrorism, assassination, war, gaming, or an activity that is unlawful* under any State or Federal law; or (2) An agreement, contract, transaction, or swap based upon an excluded commodity, as defined in Section 1a(19)(iv) of the Act, which involves, relates to, or references an activity that is *similar* to an activity enumerated in § 40.11(a)(1)

² CEA §1a(19)(iv).

³ CFTC, *Concept Release ...*, 73 Fed. Reg. 25669 at 25669-70 (May 7, 2008).

⁴ §5c(c)(5)(C)(i)-(ii) (emphasis supplied).

⁵ CFTC, *Final Rule, Provisions Common to Registered Entities*, 76 Fed. Reg. 44776 (Jul. 27, 2011).

⁶ “an occurrence, extent of an occurrence, or contingency (other than a change in the price, rate, value, or level of a commodity not described in clause (i)) that is— (I) beyond the control of the parties to the relevant contract, agreement, or transaction; and (II) associated with a financial, commercial, or economic consequence.”

of this part, ***and that the Commission determines***, by rule or regulation, to be contrary to the public interest.⁷

In Rule 40.11(a)(1), as expressly permitted by §745, the CFTC made the determination that event contracts that meet five of Congress’s six reasons ***are*** contrary to the public interest and therefore ***are*** prohibited. In Rule 40.11(a)(2) the CFTC included Congress’s statutory mechanism for making a further “similar” determination for any specific contract that is “***similar***” to the first five reasons ***and*** against the public interest.

For example, on December 15, 2020, the CFTC received a self-certification by the Eris futures exchange for listing three financially settled contracts called “RSBIX NFL Futures Contracts.”⁸ The CFTC told Eris that it had determined that these futures contracts “may involve, relate to, or reference . . . gaming” under Rule 40.11, instructed Eris to suspend listing the proposed futures contracts for a 90-day review period,⁹ and posted questions for public comment.¹⁰ I and others commented.¹¹ Eris’s futures contracts involved, related to, ***and*** referenced sports gambling, as was clear in their names¹² – the “moneyline,”¹³ “point spread,”¹⁴ and “over/under”¹⁵ for individual games – terms of sports gambling and the three main types of illegal sports bets.¹⁶ The standard of Rule 40.11(a)(1) is “gaming,” not “illegal gaming.” An “activity that is unlawful under any Federal or State law” under §5c(c)(5)(C)(i)(I) is a separate and distinct prohibition than “gaming” under §5c(c)(5)(C)(i)(V).

Therefore, even if gambling on football was legal in every state, the ErisX contracts were prohibited under the statute and Rule 40.11 because they referenced “gaming” and football is a “game.” On March 22, 2021, just one day before the end of

⁷ 17 C.F.R. §40.11 (emphasis supplied).

⁸ Eris, CFTC Regulation 40.2(a) Certification (Dec. 14, 2020) (“Eris Certification”), avail. at <https://www.cftc.gov/sites/default/files/filings/ptc/20/12/ptc121520erisdcm005.pdf>.

⁹ Letter from Christopher J. Kirkpatrick, Secretary of the Commission, CFTC, to Mr. Thomas Chippas, Chief Executive Officer, Eris (Dec. 23, 2020), avail. at <https://www.cftc.gov/sites/default/files/filings/documents/2020/orgdcmerrsignedletter201223.pdf>.

¹⁰ CFTC, Release No. 8345-20, *CFTC Announces Review of RSBIX NFL Futures Contracts Proposed by Eris Exchange, LLC* (Dec. 23, 2020), avail. at <https://www.cftc.gov/PressRoom/PressReleases/8345-20>.

¹¹ Comments for Industry Filing 20-004, avail. at avail. at <https://comments.cftc.gov/PublicComments/CommentList.aspx?id=5203>; my comment at avail. at <https://comments.cftc.gov/Handlers/PdfHandler.ashx?id=31489>. See discussion at Zachary Zagger, *Sportsbooks Could Use Derivatives Market, But Is It Betting?*, Law360, Feb. 17, 2021, avail. at <https://www.law360.com/articles/1355199/sportsbooks-could-use-derivatives-market-but-is-it-betting->.

¹² Eris Certification, pp. 4-6.

¹³ E.g., Sports Interaction Insights, *Moneyline Betting Explained*: “A moneyline bet is one of the easiest kinds of bets you can make at a sportsbook.”, avail. at <https://news.sportsinteraction.com/guide/moneyline-betting-explained>.

¹⁴ E.g., Bookies.com, *Point Spread Betting Explained*, avail. at <https://bookies.com/guides/what-is-point-spread-betting>.

¹⁵ E.g., Bookies.com, *Understanding Over/Under Betting For Sports Bettors* (“In NFL betting, the Over/Under is the most popular way to wager on totals, with lines set for every game on Sunday and in prime time for Monday Night Football and Thursday Night Football.”) avail. at <https://bookies.com/guides/how-to-do-over-under-betting>.

¹⁶ See Appendix A, “Sports Wagering Primer” in Strumpf, Dept. of Economics, Univ. of N.C., Chapel Hill, *Illegal Sports Bookmakers* (Feb. 2003) avail. at <http://users.wfu.edu/strumpks/papers/Bookie4b.pdf>.

the 90-day review period, Eris withdrew its self-certification.¹⁷ It soon became apparent that the CFTC would have issued an order denying the NFL Contracts.

Public statements by two CFTC Commissioners over the following weeks, as well as the Freedom of Information Act, highlighted a deficient CFTC rulemaking process,¹⁸ which with additional deficiencies continues to be applied by the CFTC to the Kalshi contracts. Then-Commissioner Quintenz, who went on to work for Kalshi,¹⁹ publicly stated, “the statute is unconstitutional, the regulation is invalid, and even without those issues, there were flaws in the Order that made it arbitrary and capricious.”²⁰ Then-Commissioner Dan Berkovitz’s made a public statement that treated the CFTC’s public interest determination in Rule 40.11 as if it had never happened,²¹ even though he was the CFTC’s General Counsel when Rule 40.11 was promulgated.²²

By §745 of the Dodd-Frank Act, as implemented in part by Rule 40.11(a), Congress made a policy determination to restrict certain event contracts. The standard of Rule 40.11 and §745 is not whether the trader of the instrument is involved in the illegal activity; it is whether *the instrument* has any involvement with, relationship to, or reference of listed activities. Therefore, the CFTC should not have approved the Eris contracts. An earlier CFTC Order prohibiting a Nadex election contract for involving gaming within the meaning of §5c(c)(5)(C)(V)²³ was incorrect. The prohibition is not whether people can make an illegal bet on an outcome- for example who will win an election or whether the price of wheat will increase- since people can make illegal bets on anything, including the direction of any price of any futures contract, but whether *the instrument “involves, relates to, or references”* activities listed by the CFTC as against the public interest in Rule 40.11. These are “terrorism, assassination, war, gaming, or an activity

¹⁷ Alexander Osipovich and Dave Michaels, *NFL Futures Plan Withdrawn as Regulator Prepared to Reject It*, Wall Street Journal, Mar. 23, 2021, avail. at https://www.wsj.com/articles/nfl-futures-plan-withdrawn-by-exchange-as-regulator-prepared-to-spike-it-11616521600?st=4woyq3k67shbwg6&reflink=article_email_share&mg=prod/com-wsj.

¹⁸ Jeremy Weinstein, *Football Gambling Futures Contract: Can the CFTC Measure up to the Keystone Cops?*, 41 Futures and Derivatives Law Report (Aug. 2021), avail. at <https://bit.ly/3qJrBZ4>.

¹⁹ *Former CFTC Commissioner Brian Quintenz Joins Our Board* (Nov. 16, 2021), avail. at <https://kalshi.com/blog/former-cftc-commissioner-brian-quintenz-joins-our-board>.

²⁰ Statement of Commissioner Brian D. Quintenz on ErisX RSBIX NFL Contracts and Certain Event Contracts: Any Given Sunday in the Futures Market (Mar. 25, 2021) B.3, avail. at <https://www.cftc.gov/PressRoom/SpeechesTestimony/quintenzstatement032521>.

²¹ Statement of Commissioner Dan M. Berkovitz Related to Review of ErisX Certification of NFL Futures Contracts: Sports Event Contracts: No Dice Unless There is an Economic Purpose and the Exchange is Open to the Public (Apr. 7, 2021), avail. at <https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement040721>.

²² CFTC, *Commissioner Dan M. Berkovitz*, avail. at <https://web.archive.org/web/20190321055134/avail> at <https://www.cftc.gov/About/Commissioners/CommissionerDanMBerkovitz/index.htm>.

²³ CFTC, *In the Matter of the Self-Certification by North American Derivatives Exchange, Inc., of Political Event Derivatives Contracts and Related Rule Amendments under Part 40 of the Regulations of the Commodity Futures Trading Commission* (Apr. 2, 2012) at p. 2, avail. at <https://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/nadexorder040212.pdf>. See CFTC, Release No. 6224-12, *CFTC Issues Order Prohibiting North American Derivatives Exchange’s Political Event Derivatives Contracts* (Apr. 2, 2012), avail. at <https://www.cftc.gov/PressRoom/PressReleases/6224-12> (“the contracts involve gaming and are contrary to the public interest, and cannot be listed or made available for clearing or trading”).

that is unlawful under any State or Federal law” or “an activity that is *similar ... and* that the Commission determines, by rule or regulation [i.e., not on a one-off basis],²⁴ to be contrary to the public interest.” The Eris contracts referenced gaming. In contrast, the Kalshi instruments *do not reference* terrorism, assassination, war, gaming, or an activity that is unlawful under any state or federal law, or any similar activity that the Commission has determined by rule or regulation to be contrary to the public interest. Rather, they reference elections, which are legal under all state and federal laws, and present risks that people could use the contracts to hedge.

Last year in response to a Kalshi self-certification, the CFTC posted and asked its Questions on the Kalshi “Will <party> be in control of the <chamber of Congress>?” Contracts for Public Comment (“CFTC 2022 Questions”).²⁵ Many responded to the CFTC 2022 Questions, including me.²⁶ Yet, the CFTC provided no indication of what the CFTC did with all that public input. In fact, a self-appointed market “watchdog” complained to the CFTC’s inspector general when one Commissioner sought to shed some light on it.²⁷

After the CFTC’s vaporware Kalshi elections contract review, the CFTC withdrew previously granted no action relief to a venue that trades election event contracts.²⁸ The reason the CFTC stated was “The [venue] has not operated its market in compliance with the terms of Letter 14-130.” The CFTC provided no indication of evidence of the manipulation risks of which it asked in the CFTC 2022 Questions or the CFTC 2023 Questions. That withdrawal is currently in litigation.²⁹

If the CFTC does not want election event futures contracts, it can propose rules

²⁴ The texts of CEA §5c(c)(5)(C) and Rule 40.11 differ. The statute authorizes the CFTC to make a determination that types of activity could be against the public interest, whereas in the text of Rule 40.11 the CFTC made such a determination. See answer to Question 1 below.

²⁵ CFTC, Release Number 8578-22, *CFTC Announces Review and Public Comment Period of KalshiEx Proposed Congressional Control Contracts Under CFTC Regulation 40.11*, Aug. 26, 2022, avail. at <https://www.cftc.gov/PressRoom/PressReleases/8578-22>.

²⁶ Avail. at <https://comments.cftc.gov/Handlers/PdfHandler.ashx?id=33678>.

²⁷ Better Markets, *Better Markets Files Complaint With CFTC IG To Investigate CFTC Commissioner Pham’s Apparent Disclosure Of Highly Confidential Agency Information Involving Kalshi’s Application*, December 9, 2022, avail. at <https://bettermarkets.org/newsroom/better-markets-files-complaint-with-cftc-ig-to-investigate-cftc-commissioner-phams-apparent-disclosure-of-highly-confidential-agency-information-involving-kalshis-application/>. Better Markets has also demanded that said Commissioner recuse herself from this process. Better Markets, *The CFTC Should Not Be Used As A Sneaky Backdoor To Unleash Gambling On U.S. Elections, Undermining Public Trust, Democracy, And The Commodity Markets*, June 26, 2023, avail. at <https://bettermarkets.org/newsroom/the-cftc-should-not-be-used-as-a-sneaky-backdoor-to-unleash-gambling-on-u-s-elections-undermining-public-trust-democracy-and-the-commodity-markets/>.

²⁸ CFTC Letter No. 22-08, Withdrawal of CFTC Letter No. 14-130 (Aug. 4, 2022), avail. at <https://www.cftc.gov/csl/22-08/download>. CFTC Staff Letter 14-130 (Oct. 29, 2014); CFTC, *CFTC Staff Provides No-Action Relief for Victoria University of Wellington, New Zealand, to Operate a Not-For-Profit Market for Event Contracts and to Offer Event Contracts to U.S. Persons*, avail. at <https://www.cftc.gov/PressRoom/PressReleases/7047-14>.

²⁹ *Clarke et al. v. CFTC*, 5th Cir., case no. 22-51124. See, e.g., Katryna Perera, *5th Circ. Judge Decries CFTC ‘Bully’ In Election Betting Suit*, Law360, February 8, 2023; *Election Betting Co. Can Continue For Now*, 5th Circ. Says, Law360, Jan. 27, 2023; Katryna Perera, *Election-Betting Firm Sues CFTC Over Order To Shut Down*, Law360, Sept. 12, 2022.

that prohibit them in a public rulemaking process in accordance with the Administrative Procedures Act. It can provide the regulations of event contracts that it teased 15 years ago.³⁰ Right now, the CFTC does not have a rule that prohibits the Kalshi contracts; certainly they are not prohibited by §5c(c)(5)(C) or Rule 40.11.

Part Two

Several of the CFTC's numbered questions are set forth below with my responses.

1. Do these contracts involve, relate to, or reference gaming as described in Commission regulation 40.11(a)(1) and section 5c(c)(5)(C) of the Commodity Exchange Act, or in the alternative, involve, relate to, or reference an activity that is similar to gaming as described in Commission regulation 40.11(a)(2) and section 5c(c)(5)(C) of the Commodity Exchange Act?

No, they do not. These contracts are not about games or subjects of gambling, such as a football game or whether a roulette wheel will stop on red. People can make legal or illegal bets on any outcome- for example who will win an election or by how much the price of wheat or interest rates will increase. Therefore, to say these contracts involve gaming would be to say that all futures contracts involve gaming. Please see discussion in Part One above.

The CFTC 2023 Questions and CFTC 2022 Questions differ for this question. In 2022, the CFTC asked about “regulation 40.11(a)(2) or section 5c(c)(5)(C)”. The texts of §5c(c)(5)(C) and Rule 40.11 differ. The statute authorizes the CFTC to make a determination that types of similar activity could be against the public interest, whereas in Rule 40.11 the CFTC made such a determination. Nowhere does §5c(c)(5)(C)(i) say that the CFTC must make its public interest determination on a contract-by-contract basis. In fact, §5c(c)(5)(B),³¹ referring to approval as the default state unless prohibited, and the prohibition of §5c(c)(5)(C)(ii) against listing any contract “determined by the [CFTC] to be contrary to the public interest” under § 5c(c)(5)(C)(i), each refer to futures contracts in the singular, while §5c(c)(5)(C)(i), which authorizes the CFTC to make public interest determinations, refers to contracts in the plural. This change to Question 1 perhaps indicates that the CFTC believes “gaming” has the same meaning in the statute and the rule.

2. What role does the requirement that the contracts trade in multiples of 5000 and/or the position limits applicable to the contracts play in the analysis of whether the contracts involve, relate to, or reference gaming as described in Commission regulation 40.11(a)(1) and section 5c(c)(5)(C) of the Commodity Exchange Act?

None, since the contracts do not involve, relate to, or reference “(I) activity that is

³⁰ CFTC, *Concept Release on the Appropriate Regulatory Treatment of Event Contracts*, 73 Fed. Reg. 25669 (May 7, 2008); comment file at <https://www.cftc.gov/LawRegulation/PublicComments/08-004.html>.

³¹ “The Commission shall approve a new contract or other instrument unless the Commission finds that the new contract or other instrument would violate this chapter (including regulations).”

unlawful under any Federal or State law; (II) terrorism; (III) assassination; (IV) war; (V) gaming; or (VI) *other similar activity* determined by the Commission, by rule or regulation, to be contrary to the public interest.” Please see discussion in Part One above.

3. Should the Commission consider whether similar offerings are available in traditional gaming venues such as casinos or sports books and/or whether taking a position on elections or congressional control is defined as gaming under state or federal law?

No. The prohibition is not whether people can make a legal or illegal bet on an outcome - for example who will win an election or on the closing price of a futures contract in wheat or interest rates next Tuesday - but whether *the instrument “involves, relates to, or references”* “(I) activity that is unlawful under any Federal or State law; (II) terrorism; (III) assassination; (IV) war; (V) gaming; or (VI) *other similar activity* determined by the Commission, by rule or regulation, to be contrary to the public interest.” Please see discussion in Part One above.

4. Do these contracts involve, relate to, or reference “an activity that is unlawful under any State or Federal law” as described in Commission regulation 40.11(a)(1) and section 5c(c)(5)(C) of the Commodity Exchange Act?

No. Elections are legal under all state and federal laws, just as buying and selling wheat futures or interest rate futures on a DCM is legal under all state and federal laws.

5. In determining whether these contracts involve an activity that is unlawful under any State or Federal law, should the Commission be influenced by whether state laws permit betting on the outcome of elections or other political outcomes and/or by the prohibition of interstate betting under Federal law?

No. “Wagering” is illegal in most states, and it is not the subject of the wager that is illegal. People can break the law by illegally “wagering” on football games, which raindrop will reach the bottom of a train window first, an election outcome, or next Tuesday’s closing price of the March 2024 wheat futures contract. Rule 40.11 prohibits contracts that help people in the business of wagering, not contracts that reference something on which people might wager.

The availability of hedging instruments, including those traded in public futures markets, is an essential tool for businesses to mitigate commercial risks.³² Reducing commercial risks through hedging³³ enhances the ability of any business to succeed. That is what the ErisX futures contracts would have done for organized crime. The ErisX contracts would have given illegal bookies futures contracts to hedge their commercial

³² Thomas A. Hieronymus, *The Economics of Futures Trading* (Commodity Research Bureau, 1971); CFTC, *Final Rule, Position Limits for Derivatives*, 86 Fed. Reg. 3236 at *passim* (Jan. 14, 2021).

³³ “Hedging occurs when positions acquired are economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise. See, e.g., 17 CFR 1.3(z) (definition of bona fide hedging).” CFTC, *Concept Release ...*, 73 Fed. Reg. 25669 at 25672 n. 16.

risks by allowing the futures markets to be used for layoff betting.³⁴ Giving illegal bookies a futures contract to hedge their commercial risks likewise would enhance their ability to succeed. Sports gambling and illegal sports bookmaking are foundational tools for organized crime.³⁵ The ability to hedge commercial risk helps businesses succeed, and the ability to use these futures contracts to hedge commercial risk would have helped these illegal businesses succeed. That success would have inflicted upon the public more of all of the harms that accompany illegal gambling, including money laundering, loan sharking,³⁶ extortion, game-fixing, corruption, infiltration of legitimate businesses,³⁷ and broken families. Likewise, §5c(c)(5)(C)(i)(I) prohibits instruments that would permit any other criminals to hedge their risk through a contract that references crime, or provide an incentive for the commission of crime by, for example, an event contract on burglary statistics in a residential neighborhood. By prohibiting contracts that involve, relate to or reference one particular type of crime, “assassination,” §5c(c)(5)(C)(i)(III) seeks to avoid creating any economic incentive for an assassination.

No such use may be made of the Kalshi contracts and they are accordingly not prohibited by §5c(c)(5)(C)(i)(I).

6. Are the contracts substantively different from Nadex’s previously proposed political event contracts such that the Commission’s analysis should be different? For reference, please see “CFTC Order Prohibiting North American Derivatives Exchange’s Political Event Derivatives Contracts” (Apr. 2, 2012)...

Maybe. It does not matter, since the Nadex Order prohibiting an election contract

³⁴ Morris Ploscowe, *New Approaches to Gambling, Prostitution and Organized Crime*, 38 Notre Dame L. Rev. 654, 655-56 (1963) (“Lay-off Betting. Every bookmaker from time to time gets more action on a particular horse or a particular sporting event that he can handle. The losses, in case the bettor wins, may be too great for the individual bookmaker. Like any businessman, therefore, the bookmaker tries to reinsure himself against large losses through the mechanics of lay-off betting. The risks of too great losses are spread through several layers of the bookmaking hierarchy. The top echelons of the hierarchy may take an additional step to insure themselves against too large losses. They may at the last minute bet substantial sums on the horse on which they have large bets (this is so-called comeback money). In this way, if a horse wins, they will have considerable moneys from the track with which to pay off bettors.”).

³⁵ “For the last century and a half, gambling has been the cornerstone of organized crime, providing both power and capital” Prof. Gary Potter, *Criminal Organizations: Vice, Racketeering and Politics in an American City*, p. 72 (1994). See also Kevin B. Kinnee, *Practical Gambling Investigation Techniques*, ch. 1 (Elsevier 1992).

³⁶ FBI, *Illegal Sports Betting*, avail. at <https://www.fbi.gov/scams-and-safety/common-scams-and-crimes/illegal-sports-betting>: “Illegal sports betting has real consequences for people who place and receive wagers—and for the safety of the American public. Organized crime groups often run illegal gambling operations. These groups often use the money made from illegal gambling to fund other criminal activities, like the trafficking of humans, drugs, and weapons. These operations may also be involved in tax evasion and money laundering. One of the FBI’s priorities is to investigate organized crime groups that operate illegal sports betting operations and disrupt and dismantle their activities. Besides possibly funding organized crime activities, people who place wagers with illegal sports betting operations may be at risk of extortion and violence, which bookmakers may use to collect debts.”

³⁷ Kevin B. Kinnee, *Practical Gambling Investigation Techniques*, p. 6 (Elsevier 1992). Mr. Kinnee’s diagram illustration is dramatized in the “Bust Out” episode 23 of HBO’s *The Sopranos* (2000).

as involving gaming within the meaning of §5c(c)(5)(C)(V)³⁸ was incorrect. The prohibition is not whether people can make an illegal bet on an outcome. Please see discussion in Part One above.

7. Are the contracts substantively different from Kalshi's previously proposed, and withdrawn, congressional control contracts? For reference, please see "CFTC Announces Review and Comment Period of KalshiEX Proposed Congressional Control Contracts Under CFTC Regulation 40.11" (August 26, 2022) ...

This question is inappropriate. The CFTC can run a redline and know the differences. The only reason to seek public input on those differences is to receive public input on the meaning and implication of those differences, and the CFTC has hidden those from the public. By its CFTC 2022 Questions, the CFTC solicited, and received, public input, and yet provided no public output. In the ErisX contracts, the CFTC solicited public input, yet provided no output. The CFTC engaged in processes by which it led the public to believe, by taking the public's time for input, that it would provide guidance that future sponsors of futures contracts could learn from and rely upon. Instead, the CFTC did not provide anything to the public. The CFTC now asks the public on the meaning of how the 2023 contracts differ from the 2022 contracts, when the public can have no idea what they mean for outcomes, because the public was not told.

That the CFTC is required to solicit public input does not excuse disrespect to the public that comes from disregarding that input.

8. Do the contracts serve a hedging function? What standard should be used in reviewing the contracts' hedging function? Is it sufficient that a contract could theoretically be used for hedging, or should an exchange provide evidence of demonstrated need by likely hedgers in the market? How often must a contract be used for hedging or what percentage of market participants or open interest must represent hedging use in order for a contract to serve a hedging function?

Yes, the contracts could serve a hedging function. In connection with the approval of a new futures contract, as a matter of law and common sense, it must be sufficient that the contract could be used for hedging, because without the contracts being available for hedging, all hedging is theoretical and there is no way a proposer could present evidence of how often a contract is used for hedging. I provide evidence of that theoretical hedging function in my answer to Question 9.

³⁸ CFTC, *In the Matter of the Self-Certification by North American Derivatives Exchange, Inc., of Political Event Derivatives Contracts and Related Rule Amendments under Part 40 of the Regulations of the Commodity Futures Trading Commission* (Apr. 2, 2012) at p. 2, avail. at <https://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/nadexorder040212.pdf>. See CFTC, Release No. 6224-12, *CFTC Issues Order Prohibiting North American Derivatives Exchange's Political Event Derivatives Contracts*, Apr. 2, 2012 ("the CFTC determined that the contracts involve gaming and are contrary to the public interest, and cannot be listed or made available for clearing or trading"), avail. at <https://www.cftc.gov/PressRoom/PressReleases/6224-12>.

9. Are there unique economic risks tied to the outcome of congressional control that cannot be hedged via derivative products on equities, debt, interest rates, tax rates, asset values, and other commodity prices?

Yes. Here are three examples:

One example is business line risk, risk is to a specific existing line of business that may be targeted by one of the political parties. Currently, proxy advisers may become subject to different economic risks based on which party controls Congress. One political party has introduced legislation to amend the Securities Exchange Act to require proxy adviser registration and compliance, opposed by the other political party.³⁹ Compliance would be expensive, and a real economic risks for proxy advisers and their stockholders for which no other hedging instruments are available.

Another example is targeted corporation risk, which is risk to a particular company that has incurred the ire of a political party. Companies in cross-hairs have the unique risks of the economic and reputational damage from boycotts, new legislation, and hearings that can be held by a party in control with the goal of harming them. This presents these companies and their stockholders with very real economic risks that these futures contracts can hedge, and for which no other hedging instruments are available.

Here are three current, real-world examples of targeted corporation risk:

A political boycott⁴⁰ of a beer company⁴¹ is being inflamed by Republican lawmakers. A Republican Senator demanded “investigation” of a beer company’s transgender-friendly marketing campaign,⁴² and that beer company should worry this could translate into hearings were the Republicans to control the Senate. This targeted corporation has so far suffered billions of dollars in revenue, and its stockholders have suffered billions of dollars in market capitalization loss.

Another is Republican retribution against a large entertainment company for speaking against legislation proposed in a state where it is the largest private employer. A Republican Congressman introduced legislation with the stated goal of bankrupting⁴³

³⁹ *House GOP Threatens Crackdown On Proxy Advisers*, Law360, Jul. 13, 2023, avail. at <https://www.law360.com/projectfinance/articles/1699304/house-gop-threatens-crackdown-on-proxy-advisers>

⁴⁰ “A political boycott uses economic coercion to force its victims to speak or act politically in a way that furthers the goals, not necessarily of the speaker, but of the boycotter.” Note, *The Political Boycott: An Unprivileged Form of Expression*, 1983 Duke L.J. 1076, 1077.

⁴¹ avail. at https://en.wikipedia.org/wiki/2023_Bud_Light_boycott.

⁴² *Cruz opens a probe into Anheuser-Busch over Dylan Mulvaney partnership*, The Hill, May 18, 2023, avail. at <https://thehill.com/homenews/senate/401114-cruz-opens-a-probe-into-anheuser-busch-over-dylan-mulvaney-partnership/>.

⁴³ Troy E. Nehls, *Rep. Troy E. Nehls Reintroduces Airlines Independent of Restrictions (AIR) Act*, May 05, 2023, “No corporation should get preferential treatment from the government—especially when it is grooming children. **Go woke, go broke.**” (emphasis supplied) avail. at

this company as punishment. If Republicans control both houses of Congress, this particular economic risk could become a reality for this targeted corporation were there also a Republican President.

Another is a threat a Republican Senator made to 51 large US law firms to hold hearings to investigate the legal advice the law firms provide clients on employment practices,⁴⁴ perhaps to see if that legal advice aligned with the Senator's views. Such hearings would present direct costs to the law firms and indirect costs by interfering with client relations. Such hearings could be held if the Republicans control the Senate, and there are no other instruments available to hedge this risk.

Another example is much broader, long-term risks for which the Kalshi contracts are not optimal hedging instruments right now, but could become such once a political party articulates specific legislation to advance its policies. For example, there are economic risks presented to American Jewry and Jewish-owned businesses by antisemitism. Today, 1 in 4 hiring managers say they are less likely to move forward with Jewish applicants.⁴⁵ Antisemitism presents economic risks to Jewish people and their businesses. Those risks become more directly hedgeable by these contracts if one party proposes legislation implementing antisemitic policies that the other party opposes.

Republican lawmakers have long engaged in dog whistle antisemitism, for example attacking Jewish financier George Soros,⁴⁶ and increasingly include overt

<https://web.archive.org/web/20230510040957/avail>. at <https://nehls.house.gov/posts/rep-troy-e-nehls-reintroduces-airlines-independent-of-restrictions-air-act>; MSNBC, *GOP lawmakers are now attacking Disney at the federal level*, May 11, 2023, avail. at <https://www.msnbc.com/the-reidout/reidout-blog/disney-desantis-boebert-no-fly-zone-rcna84030>.

⁴⁴ Tom Cotton, *Cotton Warns Top Law Firms About Race-Based Hiring Practices*, Jul. 17, 2023, "To the extent that your firm continues to advise clients regarding DEI programs or operate one of your own, both you and those clients should take care to preserve relevant documents in anticipation of investigations and litigation.", avail. at <https://www.cotton.senate.gov/news/press-releases/cotton-warns-top-law-firms-about-race-based-hiring-practices>

⁴⁵ "Key findings include: 26% of hiring managers say they are less likely to move forward with Jewish applicants; top reason for negative bias is belief Jews have too much power and control; 26% make assumptions about whether a candidate is Jewish based on their appearance; 23% say they want fewer Jews in their industry; 17% say leadership has told them to not hire Jews; 33% say antisemitism is common in their workplace; 29% say antisemitism is acceptable in their company." Reasons hiring managers stated they would be less likely to move forward with Jewish applicants included: Jews have too much power and control (38%); Jews claim to be the 'chosen people' (38%); Jews have too much wealth (35%); Jews are greedy (22%); Jews killed Jesus (18%); Jews are an inferior race (18%); Jews are oppressors (18%) and Jews are less capable (17%). Updated: Jan. 19, 2023, avail. at <https://www.resumebuilder.com/1-in-4-hiring-managers-say-they-are-less-likely-to-move-forward-with-jewish-applicants/>.

⁴⁶ A core tenet of modern antisemitism is that Jews control the world through shadowy conspiracies. See Holocaust Museum, *Protocols of the Elders of Zion*, avail. at <https://encyclopedia.ushmm.org/content/en/article/protocols-of-the-elders-of-zion>. A core tenet of both traditional and modern antisemitism is that Jews care most about money. American Jewish Committee, *5 of Kanye West's Antisemitic Remarks, Explained*, Dec. 2, 2022, avail. at <https://www.ajc.org/news/5-of-kanye-wests-antisemitic-remarks-explained>. See Umberto Eco, *The Prague Cemetery* (2010) for an explanation of antisemitism's transition from traditional to modern.

antisemitism in the Republican brand.⁴⁷ The Republican House of Representatives candidate in the 2018 general election in my district was an open Holocaust denier.⁴⁸ Republican President Trump's Executive Order 13967 parroted Nazi attacks against Jewish "degenerate art," even attacking US works of a refugee from the Nazis.⁴⁹ A Republican Congresswoman accused a wealthy Jewish family of starting California wildfires using light beams from outer space,⁵⁰ and the Republican leadership effectively

⁴⁷ E.g., Haaretz, *Antisemitism Is Now a Key Part of the Republican Agenda for America: Once fringe and denounced, extremism and antisemitism are now not only at home in the Republican Party, but built into the GOP's political strategy for the midterms and beyond. As antisemitism in America rises, this is a startling normalization of hate*, Nov. 8, 2022, avail. at <https://www.haaretz.com/us-news/2022-11-08/ty-article-opinion/premium/antisemitism-now-a-key-part-of-the-republican-agenda-for-america/00000184-56ed-dc83-a7fd-feff297c0000>; Los Angeles Times, *Denouncing antisemitism shouldn't be hard; for some Republicans, it seems to be*, Dec. 2, 2022, avail. at <https://www.latimes.com/politics/newsletter/2022-12-02/antisemitism-trump-and-the-gop-essential-politics>; *Arizona Republicans to host white nationalist antisemite Nick Fuentes at conference*, AZCentral, Jul. 11, 2023, avail. at <https://www.azcentral.com/story/opinion/op-ed/ej-montini/2023/07/11/arizona-republican-event-features-white-nationalist-nick-fuentes/70400626007/>; Media Matters, *100-plus examples of Republican politicians embracing antisemitic media since 2021*, Dec. 12, 2022, avail. at <https://www.mediamatters.org/diversity-discrimination/100-plus-examples-republican-politicians-embracing-antisemitic-media-2021>; *Dr. Oz Stood in Front of One of Hitler's Cars at a Fundraiser*, Oct. 7, 2022, avail. at <https://jezebel.com/dr-oz-stood-in-front-of-one-of-hitlers-cars-at-a-fundr-1849630627>.

⁴⁸ "A Republican candidate for Congress in California is openly running as a Holocaust denier, calling it a 'complete fabrication' in an interview with The New York Times published Friday." The Hill, *California GOP congressional candidate runs as open Holocaust denier*, Jul. 6, 2018, avail. at <https://thehill.com/homenews/campaign/395913-california-gop-congressional-candidate-runs-as-open-holocaust-denier/>.

⁴⁹ *Promoting Beautiful Federal Civic Architecture*, 85 Fed. Reg. 83739 (Dec. 23, 2020). "In the District of Columbia, classical architecture shall be the preferred and default architecture for Federal public buildings," §2(a), and the President shall be notified and given a detailed explanation if the GSA "proposes to approve a design for a new applicable Federal public building that diverges from the preferred architecture set forth in [§]2(a) ..., including Brutalist ... architecture or any design derived from or related to these types of architecture," and told "whether such design is as beautiful and reflective of ... vigor". §6(b). "Brutalist" means the style of architecture that grew out of the early 20th-century modernist movement" §3(b). EO 13967 attacked by name two buildings designed by a Jewish-born refugee from the Nazis, Bauhaus architect Marcel Breuer (HHS HQ, avail. at <https://www.hhs.gov/about/hhs-headquarters/index.html>) and Robert C. Weaver Federal Building avail. at <https://www.gsa.gov/historic-buildings/robert-c-weaver-federal-building-washington-dc>), 85 Fed. Reg. at 83740, para. 1. "Among Hitler's grand plans upon coming to power ... was to purify German culture, to promote the Apollonian 'classical' and eradicate the uncontrollably Dionysian 'primitive,' a category that included ... avant-garde modernism, Bolshevism, and Jewish culture. ... Harassment of Bauhaus artists began even earlier." NY Times, *First, They Came for the Art*, Mar. 13, 2014, avail. at <https://www.nytimes.com/2014/03/14/arts/design/degenerate-art-at-neue-galerie-recalls-nazi-censorship.html>; see also Bloomberg CityLab, *How the Bauhaus Kept the Nazis at Bay, Until It Couldn't*, Mar. 11, 2019, avail. at <https://www.bloomberg.com/news/articles/2019-03-11/100-years-later-how-the-bauhaus-resisted-nazi-germany?sref=9qd489pp>; BBC News, *Bauhaus in pictures: The architects exiled by Nazis*, 16 Jan. 2019, avail. at <https://www.bbc.com/news/in-pictures-46863364>. President Biden rescinded EO 13967. *Executive Order on the Revocation of Certain Presidential Actions*, avail. at <https://www.whitehouse.gov/briefing-room/presidential-actions/2021/02/24/executive-order-on-the-revocation-of-certain-presidential-actions/>.

⁵⁰ Zack Beauchamp, *Marjorie Taylor Greene's space laser and the age-old problem of blaming the Jews: Why conspiracy theorists always end up pointing the finger at Jews — and why that's a problem for the GOP*, Jan 30, 2021, Vox, avail. at <https://www.vox.com/22256258/marjorie-taylor-greene-jewish-space>.

backed her.⁵¹ Republican Speaker of the House Kevin McCarthy accused three Jewish people, including Soros, of trying to “buy” elections.⁵² The current front runner for the 2024 nomination for Republican presidential candidate publicly dined with open and notorious antisemites, and this was accepted by many Republicans in Congress.⁵³ The Republican conference of the House Judiciary committee supported a virulent antisemite on its Twitter feed, despite real consequences to American Jews.⁵⁴ Supporters of the

laser-anti-semitism-conspiracy-theories. “Blood libel” is the medieval false accusation that Jews kidnap and murder Christian children to use their blood to make Passover Matzah, avail. at https://en.wikipedia.org/wiki/Blood_libel; Sara Lipton, *Seven Centuries of Slander*, New York Review of Books, Sept. 23, 2022, avail. at <https://www.nybooks.com/articles/2021/09/23/blood-libel-seven-centuries-slander/>. “QAnon, conspiracy theory ... adherents believed [in] a cabal of satanic cannibalistic pedophiles within Hollywood, the Democratic Party, and the so-called ‘deep state’” Encyclopedia Britannica, *QAnon conspiracy theory*, avail. at <https://www.britannica.com/topic/QAnon>. QAnon is based in and expands upon blood libel and other antisemitic conspiracy theories. Wikipedia, *QAnon*, avail. at <https://en.wikipedia.org/wiki/QAnon#Antisemitism>. QAnon conspiracy theory is accepted, if not endorsed, by some Republican politicians. Axios, *11 GOP congressional nominees support QAnon conspiracy*, Jul. 12, 2020, avail. at <https://www.axios.com/2020/07/12/qanon-nominees-congress-gop>; *Wisconsin GOP invites QAnon, Jan. 6 conspiracy theorist to speak at state convention*, Wisconsin Examiner, May 5, 2023, avail. at <https://wisconsinexaminer.com/brief/wisconsin-gop-invites-qanon-jan-6-conspiracy-theorist-to-speak-at-state-convention/>; Wikipedia, *QAnon*, avail. at https://en.wikipedia.org/wiki/QAnon#Republican_politicians_and_organizations. The QAnon phenomena seems ripe for transition from “it’s the Democrats” to “it’s the Jews.”

⁵¹ New York Times, *Top House Republican Condemns Marjorie Taylor Greene’s Comments, but Stands by Her*, Feb. 3, 2021, avail. at <https://www.nytimes.com/2021/02/03/us/politics/kevin-mccarthy-marjorie-taylor-greene.html>.

⁵² Kevin McCarthy said on Twitter: “we cannot allow Soros, Steyer, and Bloomberg to BUY this election! Get out and vote Republican November 6th. #MAGA.” avail. at <https://twitter.com/JuddLegum/status/1055170806949523458>.

⁵³ Roll Call, *House GOP overlooks internal antisemitism, points at Democrats*, Dec. 1, 2022, avail. at <https://rollcall.com/2022/12/01/house-gop-overlooks-internal-antisemitism-points-at-democrats/>. Kevin McCarthy “went on to defend Trump, claiming the former president was ignorant of Fuentes’ well-known racist and antisemitic views when he had him over for dinner. ... Like other Republicans, McCarthy has stopped short of directly saying Trump has supported antisemitism with his actions.” Trump was not unaware of Kanye’s antisemitism, as Politico reported two months previously. Politico, *Trump and Kanye West speak amid rapper’s antisemitic rants, acquisition of Parler: A dinner between the two is in the future*, Oct. 17, 2022, avail. at <https://www.politico.com/news/2022/10/17/trump-and-kanye-speak-amid-rappers-anti-semitic-rants-aquisition-of-parlor-00062158>. PBS Newshour, *We asked 57 Republican lawmakers if they condemn Trump’s dinner with Fuentes and Ye. Here’s what they said*, Nov 29, 2022, avail. at <https://www.pbs.org/newshour/politics/we-asked-57-republican-lawmakers-if-they-condemn-trumps-dinner-with-fuentes-and-ye-heres-what-they-said>; Vanity Fair, *Surprise: A Number of Republicans Don’t Want to Condemn Donald Trump’s Dinner With a Couple of Antisemites: They too know where their bread is buttered*, Vanity Fair, Nov. 28, 2022, avail. at <https://www.vanityfair.com/news/2022/11/surprise-a-number-of-republicans-dont-want-to-condemn-donald-trumps-dinner-with-a-couple-of-antisemites>. But see Axios, *McConnell: Anyone meeting with antisemites “highly unlikely” to be president*, Updated Nov 29, 2022, avail. at <https://www.axios.com/2022/11/29/mitch-mcconnell-antisemites-2024-election>; NBC News, *RNC passes resolution condemning anti-Semitism following Trump dinner with Ye*, Jan. 27, 2023, avail. at <https://www.nbcnews.com/meet-the-press/meetthepressblog/rnc-passes-resolution-condemning-anti-semitism-trump-dinner-ye-rcna67922>.

⁵⁴ On Oct. 6, 2022, the House Judiciary Committee Republican caucus tweeted support of Kanye West, on the day Fox News aired West’s antisemitic remarks. The Republican caucus kept the tweet in place despite knowing Kanye was inspiring antisemitic intimidation in Jewish areas of the US, NBC News, *Rise in antisemitism is feared after banner saying ‘Kanye is right’ is hung over Los Angeles freeway*, Oct 24, 2022,

current second-place runner for the Republican 2024 Presidential candidate picketed Disney World with Nazi flags.⁵⁵ One can expect this to get worse, because since 2015 it has only gotten worse. Although Republicans do not have a monopoly on antisemitism,⁵⁶ too many embrace it. If Republican party antisemitism advances to legislative proposals that present American Jewry and their businesses economic risks of lost job opportunities and the need to move out of the US and sell assets at distressed prices, these contracts could hedge those risks. There are no other derivative products or commodity prices that can hedge these risks.

10. Are the economic consequences of congressional control predictable enough for a contract based on that control to serve a hedging function? Please provide tangible examples of commercial activity that can be hedged directly by the contracts or economic analysis that demonstrates the hedging utility of the contracts.

Yes, there are economic consequences of congressional control predictable enough for a contract based on such outcomes to serve a hedging function. See examples in my answer to Question 9. As an additional example, Republican-controlled House or Senate could make good on Republican threats to cause the US to default on its debt,⁵⁷

avail. at <https://www.nbcnews.com/news/us-news/banner-kanye-right-los-angeles-freeway-antisemitic-group-rcna53653>, and elsewhere in the US. ABC News, *Antisemitic message referencing Kanye West displayed outside Florida v. Georgia football game*, Oct. 31, 2022, avail. at <https://abcnews.go.com/US/antisemitic-message-referencing-kanye-west-displayed-florida-georgia/story?id=92387005>. After displaying the tweet for two months, the Republican caucus finally took it down when West pronounced his “love” of Nazis and Hitler, Variety, *Kanye West Praises Hitler in Horrifying Antisemitic Tirade*, Dec. 1, 2022, avail. at <https://variety.com/2022/music/news/kanye-west-praises-hitler-antisemitic-tirade-1235447083/>, antagonizing non-Jewish constituents, such as WWII veterans and their survivors. NBC News, *House Judiciary Republicans delete ‘Kanye. Elon. Trump.’ tweet as rapper praises Hitler: Republicans on the House Judiciary Committee had tweeted in apparent support of Ye on Oct. 6. The tweet was removed Thursday, Dec. 1, 2022*, avail. at <https://www.nbcnews.com/politics/congress/house-judiciary-republicans-delete-kanye-elon-trump-tweet-rapper-prais-rcna59654>; Le Monde, *Kanye West praises Hitler and embarrasses the Republican Party*, Dec. 3, 2022, avail. at https://www.lemonde.fr/en/international/article/2022/12/03/kanye-west-praises-hitler-and-embarrasses-the-republican-party_6006495_4.html. The Republican message to American Jews is stark and unambiguous.

⁵⁵ *Nazis Wave Swastikas & DeSantis 2024 Flags, Yell ‘White Power’ Outside Walt Disney World Entrance*, June 10, 2023, Walt Disney World News Today, avail. at <https://wdwnt.com/2023/06/nazis-rally-at-entrance-to-walt-disney-world/>; *Protesters carrying Nazi flags and DeSantis imagery gathered outside Disney World in Orlando, Florida*, Business Insider, Jun. 11, 2023, avail. at <https://www.businessinsider.com/protesters-nazi-flags-desantis-posters-outside-disney-world-2023-6>

⁵⁶ E.g., CNN, *Jewish groups denounce [Democrat] RFK Jr.’s false remarks that Covid-19 was ‘ethnically targeted’ to spare Jews and Chinese people*, Jul. 15, 2023 (“‘Covid-19 is targeted to attack Caucasians and Black people. The people who are most immune are Ashkenazi Jews and Chinese,’ Kennedy said, adding that ‘we don’t know whether it’s deliberately targeted that or not.’”), avail. at <https://www.cnn.com/2023/07/15/politics/rfk-jr-covid-jewish-groups/index.html>; *White House calls anti-Semitic Covid conspiracy theory voiced by RFK Jr. ‘vile’*, Politico, Jul. 17, 2023, avail. at <https://www.politico.com/news/2023/07/17/white-house-rfk-conspiracy-comment-00106681>.

⁵⁷ Washington Post, *Republicans warn Biden: The next debt limit increase won’t be so easy*, Dec. 13, 2021, avail. at https://www.washingtonpost.com/politics/republicans-debt-ceiling-biden/2021/12/13/b40b6c2a-59d5-11ec-9a18-a506cf3aa31d_story.html.

which would present substantially adverse economic consequences,⁵⁸ although for this risk there are hedging instruments currently available.

11. Should the Commission consider contract and position sizes, size of trade requirements, and/or an exchange's intended customer base to help assess whether a contract is likely to be used for hedging in at least some cases? Does the requirement that all contracts listed on Kalshi must be fully-collateralized affect this analysis? Does the requirement that these contracts trade in multiples of 5000 and/or the position limits applicable to the contracts affect the analysis of the hedging utility of the contracts?

The examples of corporate hedging utility in my answer to Question 9 involve risks that are substantially in excess of the 5,000 contract limit.

12. Should the Commission consider the contract design and payout to help assess the hedging utility of the contract? For example, are binary contracts useful for hedging nonbinary economic events?

The question assumes facts not in evidence. As I noted in my answer to Question 9, for Anheuser-Busch and the Walt Disney Company, the economic risks that are hedgeable by the Kalshi contracts are in fact binary.

14. Are the contracts contrary to the public interest? Why or why not?

The inquiry is not if they are contrary to the public interest, but if they involve relate to, or reference "(I) activity that is unlawful under any Federal or State law; (II) terrorism; (III) assassination; (IV) war; (V) gaming; or (VI) *other similar activity* determined by the Commission, by rule or regulation, to be contrary to the public interest." If they do not reference (I), (II), (III), (IV) or (V), which they do not, there is no public interest inquiry. Please see discussion in Part One above.

15. Could the trading of these or other political control or election-based contracts affect the integrity of elections or elections within a chamber of Congress? Could they affect the perception of the integrity of elections or elections within a chamber of Congress?

No to both. There is no way to "fix" an election the way one can "fix" a baseball game by bribing a few players. It is hard to imagine a political candidate accepting a payoff to lose an election, and even harder to imagine proving it. It is extraordinarily unlikely that a person would seek election of a national slate of candidates with policies contrary to that person's economic or political interests, simply to win a fully collateralized futures contract binary outcome. It would be far more economically efficient to leverage a position in a contract with relatively low initial margin, such as

⁵⁸ CBS News, *U.S. debt default could wipe out 6 million jobs and \$15 trillion in wealth, Moody's says*, Sept. 22, 2021, avail. at <https://www.cbsnews.com/news/debt-ceiling-default-6-million-jobs-15-trillion-wealth/>.

crude oil, that will be impacted by the policies of the winning party.

16. *Could the contracts be used to influence perception of a political party or its candidates' likelihood of success? To this end, could the contracts be used to manipulate fundraising or voting?*

One can imagine people buying futures contracts to bid up the perceived chances of a political party, but it is far cheaper and effective to do what is done now, which is to pay companies that present themselves to the public as polling companies to write bogus polls, with a view to manipulating perceptions of which candidate is winning. This was done to create the false narrative of the “red wave” of 2022 that did not come to pass.⁵⁹ Seeking power through elections and false polls is a far more rational and prevalent reason for false polling than would be moving futures contracts.

Perhaps partisans could bid up a futures contract to create a false poll of strength. The effects would be attenuated at the individual candidate level. In either event, this is solved through market depth and public understanding of the predictive power of the contract as reflecting only the views of those participating in that market. The Kalshi contract might skew to overweight the views of those participating in that market, who can afford to collateralize 5,000 contracts. Eventually academic papers will be available instructing how to model to adjust for that skew.

17. *Could the contracts facilitate violations of, or otherwise undermine, federal campaign finance laws or regulations? For example, could the contracts make it easier to sidestep prohibitions governing coordination between candidate campaign committees and political action committees?*

These contracts do not provide any opportunities to sidestep campaign finance and anti-bribery laws that are not already available from all other futures contracts.⁶⁰

Donors receive far more value for their money – ***and do so legally*** – by donating to candidates to obtain access and special favors than they could ever achieve through some fantastic illegal election futures market manipulation. Hedge fund managers got far more bang for their ***legal*** million dollars from Senator Sinema, who single-handedly prevented the closing of the carried interest tax loophole,⁶¹ than they ever could have hoped to make on futures contracts by spending hundreds of millions illegally seeking to influence hundreds of elections nationwide, especially if those races were to be won by

⁵⁹ New York Times, *The ‘Red Wave’ Washout: How Skewed Polls Fed a False Election Narrative*, Dec. 31, 2022, avail. at <https://www.nytimes.com/2022/12/31/us/politics/polling-election-2022-red-wave.html>.

⁶⁰ See, e.g., Wikipedia, *Hillary Clinton cattle futures controversy*, avail. at https://en.wikipedia.org/wiki/Hillary_Clinton_cattle_futures_controversy; Taylor & Ingersoll, *Hillary Clinton’s Commodities Broker Was Disciplined for a Variety of Violations*, Wall Street Journal; Gottschalk, *If Hillary Clinton Could Make Money in Commodities, Why Can’t You? Well, Let’s Count the Reasons*, Wall Street Journal (Mar. 28, 1994).

⁶¹ Fortune, *Kyrsten Sinema’s donations from investors surged to nearly \$1 million in the year before she killed a huge new tax on private equity and hedge funds*, Aug. 13, 2022, avail. at <https://fortune.com/2022/08/13/sinema-wall-street-money-killing-tax-investors/>.

candidates against the carried interest loophole. On a national level, political parties raise money and seek to win elections; they would not gamble the money on futures contracts, they would buy services and advertisements.

If in the future DCMs propose contracts on individual races, which are not the Kalshi contracts, the CFTC can evaluate those contracts at that time.

18. Do the contracts present any special considerations with respect to susceptibility to manipulation or surveillance requirements?⁶²

No. There are major companies that control large portions of wheat, oil, gas, or other commodity supply or demand. It is appropriate to watch for commodity market manipulation by companies improperly furthering their economic interest. In contrast, no one can “manipulate” which party controls a chamber of Congress. Considering evidence-free conspiracy theories to the contrary is not appropriate. Federal rulemaking must be reasoned.⁶³ There is no “inside information,” and any positing that there is traffics in fantasy conspiracy theory. Polling data would implicate 870 or more candidate for the House, and 66 or 67 for the Senate, and could hardly be “internal.” Please see answers to Questions 15-17 above as well.

Since these contracts are financial instruments in the US’s financial system, those inclined to traffic in antisemitism could use them as evidence in their false narrative of Jewish financier control of the country and over elections.⁶⁴ But the result will not involve the contracts being used to manipulate fundraising or voting, the result will be more antisemitism.

19. What is the price forming information for these contracts while the contracts are trading? If the price forming information includes polling and other election prediction information, is that information regulated? How does the price forming information compare to informational sources (e.g. government issued crop forecasts, weather forecasts, federal government economic data, market derived supply and demand metrics for commodities, market-based interest rate curves, etc.) that are generally used for pricing commodity derivative products within the Commission’s jurisdiction?

Reports such as crop reports, Energy Information Administration reports, and Commitment of Traders reports from the federal government represent the publication of information that people are required by regulation to report to the government. This information could be price forming for futures contracts. The government does not sponsor political polls the way it sponsors reporting the information that people are required to

⁶² The CFTC 2022 Questions also included at the end of this questions: “For example, could candidate campaign committees or political action committees manipulate the contracts by trading on internal, non-public polling data?”

⁶³ A Guide to the Rulemaking Process Prepared by the Office of the Federal Register, avail. at https://www.federalregister.gov/uploads/2011/01/the_rulemaking_process.pdf.

⁶⁴ See answer to Question 9 above.

report to it. Rather, the information concerning the leading candidate is reported when the government holds an election, people vote, and the government reports to the public the results of the election.

Unlike in the movie *Trading Places* (1983), where an orange crop report was stolen as part of a scheme to manipulate the NYMEX Frozen Concentrated Orange Juice futures contract, there is no equivalent government report for political polls, nor should there be. That is not the role of the government. Were the government to poll and to seek to regulate political polling, the inevitable result would be the party in power using this to stay in power. Policing polling is certainly not the role of the CFTC. Any such purported policing would feed a false narrative that Congressional elections may be manipulated, not address any concerns, and should have no impacts on the CFTC's determination on whether the contracts have hedging utility or involve, relate to, or reference, one of the six prohibited activities.

It is highly inappropriate for the CFTC to even hint that the government should regulate political polls; taken together with Questions 20 and 22, it seems to indicate that the CFTC is hinting that it is considering regulating polling, or harbors some belief that approving these contracts somehow would justify the CFTC in regulating polling, or that its inability to regulate polling should be a reason to not approve these contracts. The CFTC should clarify what it means by Question 19.

20. *Should, and if so how would, the registered entity listing the contracts take steps to address possible manipulative and/or false reporting activity involving the price forming information for the contracts, while the contracts are trading?*

No. It is not possible to manipulate elections the way bad actors can manipulate commodity prices. The CFTC should not regulate political polls, or require private companies to monitor and report on them, on the grounds that such polls, if false, could be used to manipulate futures prices. As was the case for the bogus polls used to generate the false narrative of the 2022 “red wave” that did not come to pass, the goal of a false poll is to win an election, not to manipulate a futures price. Perhaps someone inclined to create a false narrative of a coming win might invest in both bogus polls and trying to bid up a futures contract; this risk does not justify the CFTC seeking to directly or indirectly regulate polling, because for the latter the problem is solved by market depth. The inability of the CFTC to regulate polling should not be a reason to deny the futures contract.

The CFTC approved film box office receipt futures contracts,⁶⁵ finding them “not

⁶⁵ CFTC, Release Number 5834-10, *CFTC Approves Box Office Receipt Contracts Submitted by Media Derivatives*, <https://www.cftc.gov/PressRoom/PressReleases/5834-10>, See dissenting statement of Commissioner Sommers, <https://www.cftc.gov/idc/groups/public/@otherif/documents/ifdocs/mdexdissentingsommers061410.pdf>, noting that the CFTC even at that time (2010) needed to proceed with the events contracts rulemaking that it had floated in 2008. This remains the case. See Anderson, *Back to the Future[s]: A Critical Look at the Film Futures Ban*, 29 *Cardozo Arts & Ent. L.J.* 179 (2011), avail. at <https://www.cardozoaej.com/wp-content/uploads/Journal%20Issues/Volume%2029/Issue%201/Anderson.pdf>.

readily susceptible to manipulation,”⁶⁶ even though not only studios, but third parties, can advertise movies (an analogue to buying and promoting false polls) to affect box office receipts or deploy “insider status” to predict them. The CFTC even said that “false . . . rumors or misreporting does not constitute a legal basis to conclude that a proposed futures or options contract would violate” the CEA.⁶⁷ Film box office receipt futures had at best a tiny fraction of the potential hedging utility of the Kalshi contracts.

See also answers to Questions 19-23.

22. *Should the Commission be responsible for surveilling, and enforcing against, possible manipulative and/or false reporting activity involving the price forming information for the contracts, while the contracts are trading?*

No. The Federal Election Commission enforces against campaign finance violations. There are gasoline futures contracts, and it is the Federal Trade Commission that is responsible for surveilling and enforcing against gas market manipulation.⁶⁸ There are electricity and natural gas futures contracts, and it is the Federal Energy Regulatory Commission that is responsible for surveilling and enforcing against energy market manipulation.⁶⁹ The CFTC does not have to be responsible for surveilling and enforcing against manipulation or illegal conduct in the underlying for it to take action should the regulator with jurisdiction do so and provide the information to the CFTC.⁷⁰ There are futures on assets and prices that are subject to manipulation beyond the CFTC’s jurisdiction to regulate and investigate, and on which the CFTC can piggyback for its enforcement should manipulation be discovered by the law enforcement agency with jurisdiction. For example, the CFTC relied on the investigations of the UK Financial Conduct Authority when assessing fines against Lloyds Bank for LIBOR manipulation.⁷¹ See also answers to Questions 19-23.

23. *Could trading in the markets for the contracts obligate the*

⁶⁶ CFTC, *Statement of the Commission*, Jun. 14, 2010, pp. 6-9, avail. at <https://www.cftc.gov/idc/groups/public/@otherif/documents/ifdocs/mdexcommissionstatement061410.pdf>.

⁶⁷ CFTC, *Statement of the Commission*, Jun. 14, 2010, p. 8. Ironically, the CFTC included this Statement as Exhibit 3 in CFTC, Brief for Amicus Curiae . . . in Support of Rehearing, *Laydon v. Cooperative Rabobank, et al.*, 2d Cir. Case 20-3626, doc. 383, Nov. 29, 2022; see Law360, *CFTC Urges 2nd Circ. Redo Of Yen Libor-Rigging Suit*, Nov. 30, 2022, avail. at <https://www.law360.com/articles/1553368/cftc-urges-2nd-circ-redo-of-yen-libor-rigging-suit->.

⁶⁸ 16 C.F.R. §317 Prohibition of Energy Market Manipulation Rule; FTC, Guide to Complying with Petroleum Market Manipulation Regulations, avail. at <https://www.ftc.gov/sites/default/files/documents/rules/prohibition-energy-market-manipulation-rule/091113mmrguide.pdf>.

⁶⁹ FERC Order 670, 18 C.F.R. §1c.2 Energy market manipulation; FERC Enforcement Resources, avail at <https://ferc.gov/enforcement-resources>.

⁷⁰ E.g., Dodd-Frank Act §720.

⁷¹ Law360, *Lloyds To Pay \$370M In US, UK Libor-Rigging Deal*, Jul. 28, 2014, avail. at <https://www.law360.com/articles/561429/lloyds-to-pay-370m-in-us-uk-libor-rigging-deal>; CFTC, Release Number 6966-14, July 28, 2014, *CFTC Charges Lloyds Banking Group and Lloyds Bank with Manipulation, Attempted Manipulation, and False Reporting of LIBOR*, avail. at <https://www.cftc.gov/PressRoom/PressReleases/6966-14>.

Commission to investigate or otherwise become involved in the electoral process or political fundraising? If so, is this an appropriate role for the Commission?

No. See answers to Questions 19-22. The CFTC has not been granted authority by Congress to investigate elections or political fundraising. The CFTC does not expand its investigatory jurisdiction into an area by simply approving a contract in an underlying. The ICE futures contracts on Rotterdam coal, Brent crude oil, California Carbon allowances, London Cocoa, UK government bonds, US government bonds, UK equities, Austrian financial energy, and freight between Mediterranean ports, do not obligate the CFTC to investigate those markets that are under the primary jurisdiction of foreign governments, other federal agencies, or U.S. states, and the CFTC probably lacks the jurisdiction to do so.⁷² The CFTC cannot expand its investigatory jurisdiction whenever it likes simply by approving futures contracts that involve underlyings that it would like to investigate.

24. What other factors should the Commission consider in determining whether these contracts are “contrary to the public interest?”

The only relevant factors that the CFTC should consider are set forth in the statute. Therefore the only relevant factors for CFTC inquiry are whether elections for control of Congress are one of, or an activity that is similar to, one of “(I) activity that is unlawful under any Federal or State law; (II) terrorism; (III) assassination; (IV) war; [or] (V) gaming” They are not. Title 17 gives the CFTC no “contrary to the public interest” denial authority outside of Rule 40.11.

Conclusion

I and many other members of the public have provided very detailed responses to three CFTC requests on event contracts. I hope the CFTC has not prejudged this matter, and I hope that the CFTC will provide useful information to the public in return.

Yours truly,



Jeremy D. Weinstein

⁷² E.g., *Laydon v. Coöperatieve Rabobank U.A., et al.*, No. 20-3626 (2d Cir. Oct. 18, 2022); *West Virginia v. Environmental Protection Agency*, 597 U.S. ____ (2022).

September 24, 2022

SUBMITTED VIA CFTC PORTAL

Secretary of the Commission

Office of the Secretariat

U.S. Commodity Futures Trading Commission

Three Lafayette Centre 1155 21st Street, N.W.

Washington, D.C. 20581

Re: Questions on the KalshiEX, LLC “Will <party> be in control of the <chamber of Congress>?” Contracts for Public Comment

Honorable Chairman and Commissioners of the Commodity Futures Trading Commission (CFTC):

As the Commission and staff of the CFTC well know, speculators play a vital role in U.S. capital markets in general and futures markets in particular. Both markets assume risks that are an integral part of our well-functioning financial system, which continues to be the envy of the world. In futures markets, commercial entities transfer part of their risk to the speculator, who in turn assume that risk for the opportunity to earn a profit.

A major misconception that still prevails among the public is the equivalence of gambling and speculation. Nothing could be farther from the truth. Gambling is an artificial, self-constructed risk created for recreation. Speculation is the assumption of risks that already exist in the real and financial markets. The recreational risk of gambling is not present until the casino or racetrack is built and wagers are accepted. On the other hand, risk in the production of good and services in the economy are real and will exist even in the absence of futures markets. The same can be said for equity and interest rate and risk. It seems reasonable to conclude the risks associated with policy changes from different election outcomes are most similar to the latter. The transfer of risk by hedgers would be real and the assumption of that risk by speculators would be proper.

This distinction builds on work done by both as academics and practitioners. Almost fifty years ago, the Chicago Board of Trade published a booklet for speculators entitled “Speculating in Futures.” A copy will be sent under separate cover. It clearly underlines the differences between hedgers and speculators, their interaction as market participants and the speculators’ key role to help facilitate efficient risk transfer.

As we enter a new era with innovation in new products and “deconstruction” of existing ones, those of us who care deeply about our futures markets hope this distinction between “gambling” and

“speculation” will help guide future decisions that the Commission may encounter. As always, long time market participants and practitioners stand ready to be an unbiased resource to the Commission and its staff.

Respectfully,

Richard L. Sandor

Chairman & CEO

Environmental Financial Products

Aaron Director Lecturer in Law & Economics

University of Chicago Law School

September 25, 2022

SUBMITTED VIA CFTC PORTAL

Secretary of the Commission

Office of the Secretariat

U.S. Commodity Futures Trading Commission

Three Lafayette Centre 1155 21st Street, N.W.

Washington, D.C. 20581

Re: Questions on the KalshiEX, LLC “Will <party> be in control of the <chamber of Congress>?” Contracts for Public Comment

Honorable Chairman and Commissioners of the Commodity Futures Trading Commission:

From 2017 to 2021, I had the privilege to serve as a Commissioner of the CFTC under the leaderships of former Chairs J. Christopher Giancarlo and Dr. Heath Tarbert, and then-Acting Chair Rostin Behnam. Before my time at the agency, I ran my own investment firm, worked for a bank-focused hedge fund during the financial crisis, and served as a staffer in the House of Representatives. Since leaving public office, I have been an advisor for Andreessen-Horowitz Capital Management, Crypto.com, and sit on Kalshi’s Board of Directors.

I remember fondly a saying at the agency, “Every day is a good day at the CFTC.” Indeed it was. That was the case, however, not because the Commission avoided making hard decisions or taking the easy route on difficult issues. In fact, it was true *because* we dealt with those things and did so in an honest, transparent, and accessible manner with decisions and statements well supported by legal analysis, data, and commenters’ perspectives. In fact, during my time as a Commissioner, the agency deliberated and decided upon many philosophically challenging, controversial, and statutorily confusing matters. In the execution of my role, I found the best way to address such issues was adhering to a strong regulatory philosophy combined with a very deliberate reading of the statute and weighing the appropriateness of any existing or proposed regulations to the issue’s risks and opportunities. I commend the current Chair and Commissioners for taking a similar posture towards their duties.

I also believe, as has been expressed through our Constitution and through the precedent of multiple Supreme Court decisions, that the government has limited authority, and independent agencies cannot assume broader authorities than the statutes - passed by Congress and signed into law by the President - convey to them. Such an outcome would put into question the checks and balances of the separation of powers as well as the ability of the population to have a direct effect on the government’s decisions. Speaking of power, independent agencies have a significant amount of it. Commissioners serve for staggered terms, agencies’ regulations are

heavily insulated from congressional review, and the chairs are difficult to remove, if not debatably irremovable, from office. As such, a deliberate and concerted focus on what discrete authorities the law conveys and whether the agency is acting in accordance with those powers in a manner that is justified, consistent, and repeatable is what the American public and our derivatives markets deserve.

Throughout my time at the Commission, and consistently through its distinguished history, the CFTC has been at the forefront of market-led innovation.¹ It is precisely because of this history the United States enjoys the deepest, most liquid, and broadest derivatives markets in the world. Along those lines, during my time as a commissioner, the agency dealt with event contracts on a number of occasions: through discussions with Aristotle on the scope of PredictIt's activity, through considering and approving Kalshi's license to operate a Designated Contract Market, to Kalshi's repeated efforts to move innovative event contracts through Commission reviews, and ultimately to the Commission's consideration of ErisX's proposed RSBIX NFL Football contracts, on which I authored a statement.² Kalshi's proposed contracts on the political control of the House and the Senate is another iteration of the Commission's considerations in this space, namely another frontier in prediction market innovation as well as another opportunity for the Commission to adhere to its statute and recognize its limited authority and ultimate purpose.

I commend you for undertaking this difficult task and for your time, effort, and thoughtfulness in fully analyzing the information provided through this comment process and in reviewing these contracts themselves.

Background

In 2012, North American Derivatives Exchange, a Designated Contract Market (DCM) self-certified contracts relating to election outcomes. The Commission imposed a 90-day stay and public review of the contracts pursuant to regulation 40.11. After review, it found that the contracts involved gaming, conflicted with certain state laws, brought into question election integrity, and were contrary to the public interest. The Commission voted to prevent the contracts from being listed ("*Nadex*").³

¹ See, for instance, J. Christopher Giancarlo, Letter to the U.S. Senate Committee on Agriculture, Nutrition, and Forestry, September 15, 2022, available at: <https://static1.squarespace.com/static/609d6c0e49158533ad1ae6b9/t/63226625af0a195856b46ec7/1663198758065/Giancarlo+ltr+Senate+Ag+Ctee+re+DCCPA+9.14.22.pdf>

² See Statement of Commission Brian D. Quintenz on ErisX RSBIX NFL Contracts and Certain Event Contracts (Mar. 25, 2021), "Any Given Sunday in the Futures Market," available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/quintenzstatement032521>

³ In the Matter of the Self-Certification by North American Derivatives Exchange, Inc. of Political Event Derivatives. Contracts and Related Rule Amendments under Part 40 of the Regulations of the Commodity Futures Trading Commission (April 2, 2012), available at: <https://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/if-docs/nadexorder040212.pdf>.

Kalshi received designation as a contract market in November 2020 and exclusively lists event contracts, which depend on the outcomes of events on economic indicators like inflation and GDP growth, natural occurrences such as hurricanes and the spread of Covid-19, and outcomes of legislation like will the Build Back Better bill pass into law.. Kalshi's current proposal came after significant engagement over the last year with the Commission, the Division of Market Oversight, and legislators.

Introduction

Kalshi's proposed contracts comport with the law, would provide meaningful economic and social benefits, and should be approved. Further, because it is critical for the agency to make determinations based on the law and not speculation, fear, or comfort, the Commission can not and should not disapprove these contracts. Such reasoning is important not only for the members of the marketplace and registrants, but for the Commission's reputation and standing itself. This decision will have significant implications for the future of the marketplace. Kalshi's proposal presents the Commission with an opportunity to right the wrongs of *Nadex*, and make a decision compliant with the law and consistent with broad segments of futures market activity.

The contract does not trigger the special rule

Section 5c(c)(5)(C)(i) of the Commodity Exchange Act (CEA) establishes the "Special rule for review and approval of event contracts and swaps contracts."⁴ It reads:

(i) Event contracts

In connection with the listing of agreements, contracts, transactions, or swaps in excluded commodities that are based upon the occurrence, extent of an occurrence, or contingency (other than a change in the price, rate, value, or levels of a commodity described in section 1a(2)(i) [2] of this title), by a designated contract market or swap execution facility, the Commission may determine that such agreements, contracts, or transactions are contrary to the public interest if the agreements, contracts, or transactions involve—

- (I)** activity that is unlawful under any Federal or State law;
- (II)** terrorism;
- (III)** assassination;
- (IV)** war;
- (V)** gaming; or

⁴ 7 U.S.C § 7a-2(c)(5)(C)(i)(I)-(VI).

(VI) other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.⁵

The special rule includes three important steps for a contract to be relevant. First, the contract in question must be “based upon the occurrence, extent of an occurrence, or contingency”; in other words, an event contract. Second, the contract’s event must *involve* at least one of the enumerated activities. Then, if the Commission finds that the contract does involve one of the enumerated activities, it may determine the contract as a whole to be contrary to the public interest.

Nadex concluded that *participating* in the political event contracts in question was equivalent to ‘wagering’ or ‘betting’, and thus gaming, to trigger the special rule. Beyond its blatantly incorrect reading of the statute, this is a shockingly poor and vague classification of activity that would scope in common and vital participation in the futures market.

How should the line between morally dubious gaming activity and important and valuable speculative activity be drawn? Gaming describes wagering money on an occurrence that has no inherent economic value itself other than the money wagered on its outcome. For instance, wagering money on roulette or blackjack should be considered gaming because there is no economic significance of the activity apart from the wager itself. Speculation, on the contrary, is risking value where the underlying activity has economic consequences, which then means the speculative activity creates valuable societal and economic benefit from a price-discovery and risk transfer function for those exposed to the risk of that underlying activity.

Unbelievably, the Commission never concretely defined or even philosophically stated the difference between “gaming” as represented in 5c(c)(5)(C)(i) and the speculation that exists every day in derivatives marketplaces and is a critical component of their purpose. But yet, it has chosen to, and may choose to again here, apply a term it hasn’t defined to an activity that is actually more similar to traditional and valuable speculative market participation. Multiple esteemed and long-time futures market participants and former CFTC officials have commented

⁵ *Id.*

similarly in this filing.^{6 7 8 9 10 11 12 13} The Commission would owe them a strong explanation if its conclusion on this point has not changed.

There are plenty of events that have a discernable and legitimate economic impact and whose probabilistic outcomes can be estimated through an analysis of relevant factors. They are not gambling activities nor are they games of chance. That is just as true for election outcomes as it is for the prices, production, and demand of things like oil, corn, or gold. Hedge funds put infrared cameras on natural gas processing facilities to know the minutes they are operating or shut down so they have an edge on estimating production figures. Some investment firms have micro climate weather experts so as to more accurately predict localized rainfall and drought conditions to get a better estimate on crop yields. Those same firms' market positions then also provide a strong economic benefit. If the firms are confident enough in their predictions, they will move the equilibrium price and provide a market signal to any business involved (from production to processing to distribution) of the economic value that can be hedged based on an event's perceived outcome. Estimating election outcomes and expressing that view through a market mechanism is just as valuable to society as estimating oil, corn, or gold fundamentals and expressing those views through existing futures contracts. As a case in point, the demand for such predictive election information has exploded in recent years and has been the basis of entire publications like *FiveThirtyEight* or *The New York Times*' "needle".

From a statutory perspective, the relevant portion of the CEA prohibits registered boards of trade from listing event contracts whose *underlying activities* reference one of the enumerated activities. The CEA did not give the Commission authority to conclude that participating in the contract could constitute one of the enumerated activities. The statute is very clear on this matter:

(i) The statute limits the scope of the Commission's authority to "activities" and activities only. The Commission only has discretion to take action on event contracts whose event involves (1) an "activity" that is unlawful under federal or state law; (2) one of four specifically listed "activities" (terrorism, assassination, war, or gaming); or (3) other similar "activity" determined by the Commission to be contrary to the public interest. The Commission itself has previously

⁶ Public comment on Kalshi's proposal by **Dr. Richard Sandor**.

⁷ Public comment on Kalshi's proposal by **Christopher Hehmeyer**. Available here: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69717>

⁸ Public comment on Kalshi's proposal by **Mark Wetjen**. Available here: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70771>

⁹ Public comment on Kalshi's proposal by **Josh Sterling**. Available here: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69737>

¹⁰ Public comment on Kalshi's proposal by **Daniel Gorfine**. Available here: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70755&SearchText>

¹¹ Public comment on Kalshi's proposal by **Paul Fribourg**. Available here: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69727&SearchText>

¹² Public comment on Kalshi's proposal by **David Pollard**. Available here: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70743>

¹³ Memoranda by **Jonathan Marcus** and **Daniel Davis** are also included in Kalshi's submission.

acknowledged that the special rule's textual focus is on "activities," i.e., the underlying conduct. In describing it, the Commission stated that the rule applied to contracts that "involve one or more activities enumerated in the Dodd-Frank Act."¹⁴ These "activities" are not the contracts themselves. They are the events that create the basis for the relevant contract.

(ii) If Congress assumed, as the Commission implies through *Nadex*, that the act of participating in a event contract could itself constitute gaming, there would have been no need for Congress to individually enumerate "gaming" as a distinct category of event contracts upon which the Commission could make a public interest determination, since they would already fall under the "unlawful activity" prong.

(iii) If state gambling definitions of 'wager' and 'bet' are analogous to the act of taking a position in the Political Event Contracts, as *Nadex* argues,¹⁵ then those same state definitions would be analogous to taking a position on any event contract, including ones whose underlying activity is an economic indicator or the weather. The Commission cannot hold that participating in these proposed contracts involve gaming without also implicating participation in all other event contracts. Such an outcome would also clearly be in tension with the purpose of the statute, which is to carve out a select few event contracts with an underlying activity that is specifically referenced or subsequently identified by the Commission through a rulemaking.

(iv) This interpretation would require the Commission to interpret "involve" differently across the enumerated activities, since participating in any event contract itself clearly cannot ever constitute an act of assassination, war, or terrorism.

(v) The statute actually prevents events with no financial impacts to be considered as excluded commodities. In order for the Special Rule in 5c(c)(5)(C)(i) to apply to Kalshi's contracts, those contracts already have to be on events that are considered excluded commodities. The statutory definition of an excluded commodity includes "...an occurrence, extent of an occurrence, or contingency...that is 1) beyond the control of the relevant parties to the contract...and 2) associated with a financial, commercial, or economic consequence."¹⁶ Because Kalshi's contract is on excluded commodity, subject to the Commission's jurisdiction and being vetted through the Special Rule, then, by the very definition of an excluded commodity in the statute, the event contains an economic risk that can be hedged. If the event did not then that event would constitute gaming, not an excluded commodity, and not subject to the Commission's purview.

¹⁴ *Provisions Common to Registered Entities: Proposed Rule*, 75 Fed. Reg. 67,282, 67,283 (Nov. 2, 2010) ("Section 745 of the Dodd-Frank Act also authorizes the Commission to prohibit the listing of event contracts based on certain excluded commodities if such contracts involve one or more activities enumerated in the Dodd-Frank Act.") ("40.11 Proposed Rule"); see 17 C.F.R. § 40.11(a) at 67,289 ("If [] the Commission determines that such product may involve an activity that is enumerated in 40.11")

¹⁵ *Nadex* at 2-3.

¹⁶ 7 U.S.C. § 1a(19)(iv)

Questions: Other venues' offerings

In the second question posed to the public for comment, the Commission asked whether it should consider “similar offerings are available in traditional gaming venues such as casinos or sports books and/or whether taking a position on elections or congressional control is defined as gaming under state or federal law” when making its gaming determination. It is difficult to understand the rationale for including this question (but that sentiment is not unique to this question either, as this is one of several examples of arbitrary standards proposed through the Commission’s questions to the public). Strikingly, this specific question was not asked of the public when it was considering the legality of ErisX’s proposed NFL Futures contracts, which are a staple of such venues.¹⁷ Additionally, this standard is not found in law or in Commission history and precedent. Moreover, partisan control of Congress is not a bet available on any legal American sportsbook. That it is sometimes available on illegal ones cannot be held against Kalshi’s proposal. Taking a possible motive of this question to its potentially backward conclusion, it would be challenged regulatory logic to allow bucket shops, illegal venues, casinos, or offshore markets to preclude a CFTC registered exchange from offering a contract by virtue of listing that contract themselves. Similarly, we are fortunate the agency has never proposed this standard in the past, as it would have likely precluded the exchange listing of many new derivatives products. The most recent example of such is the agency’s greenlight for CBOE’s and CME’s Bitcoin futures contracts, which traded in some form or fashion in many unregulated venues before listing on CFTC registered DCMs.

Question: State laws

The Commission has asked whether Kalshi’s proposal involves state law provisions that prohibit ‘wagering’ on the outcomes of elections, in addition to the federal prohibition on interstate gambling (questions three and four). As discussed at length above, the statute refers to the underlying activity of the contract, not the contract itself. The contract only involves obviously legal activity: the partisan affiliation of the Speaker of the House and President *pro tempore*.

However, even if the Commission did consider the contract as a whole instead of just the contract’s underlying event against state laws, the contract nonetheless does not involve illegal activity. Because of preemption, a contract offered by a registered board of trade otherwise compliant with the law and regulations could never constitute unlawful state activity. There is no scenario where a Kalshi member would be illegally trading the proposed contract on the exchange from a state law perspective.

¹⁷ Questions on the Eris Exchange, LLC (“ErisX”) RSBIX NFL Futures Contracts for Public Comment. Available at: <https://www.cftc.gov/sites/default/files/filings/documents/2020/orgdcmerisquestionsre201223.pdf>

In addition, the definition of gaming cited by *Nadex* in federal law had a carveout specifically for regulated derivative products like Kalshi's proposal, as do many state laws regarding gaming. Similarly, the Commodity Futures Modernization Act of 2000 explicitly overrules state gaming and bucket shop provisions. State laws should not be relevant whatsoever in this instance and should not be considered in this process.¹⁸

Questions: Hedging and price basing standards

In its questions for the public, the Commission asks what standard should be used to determine whether Kalshi's contracts serve a hedging function (question six) and whether or not a registrant must provide demonstrated need of hedging and whether the Commission should consider the proportion of hedgers in the market (question eight).

Prior to its deletion in 2000 by the CFMA, CEA Section 5(g) provided that the Commission could not designate a board of trade as a contract market unless the board of trade affirmatively and pro-actively demonstrated that transactions in their contracts "will not be contrary to the public interest."¹⁹ The Commission interpreted the words "public interest" to include an economic purpose test, which required that exchanges affirmatively demonstrate to the Commission that a proposed contract could be used for hedging or price basing.^{20 21} In 2000, the CFMA repealed Section 5(g) of the CEA in its entirety.

In 2010, Congress passed the Dodd Frank Act, which added the new special rule in CEA section 5c(c)(5)(C) for the Commission to disapprove the enumerated event contracts. This section left untouched the CFMA's revised structure for contract certification. It did not add back any requirement for an exchange to affirmatively demonstrate that a contract has price hedging utility or any other burden to show that a contract was not contrary to the public interest.

In *Nadex*, the Commission re-imposed the economic purpose test on *Nadex*'s political contracts, based on what is presumed to be a short dialogue between Senators Feinstein and Lincoln in the Congressional record. Turning to the legislative history, or specifically a dialogue between only two of the 535 members of the House and Senate, on this matter is a reach. The law which both chambers passed and the President signed is clear, and Congress specifically removed the economic purpose test from the law. Rather than re-enact the economic purpose test, Congress specifically chose instead to create the special rule to target contracts whose events dealt with events that could be contrary to the public interest. The Commission should not—and

¹⁸ 7 U.S.C § 16a-2.

¹⁹ H.R. Rep. No. 975, 93 Cong., 2d Sess. 29 (1974).

²⁰ Concept Release on the Appropriate Regulatory Treatment of Event Contracts, 73 FR 25669, 25672 (May 7, 2008).

²¹ A Joint Report of the SEC and the CFTC on Harmonization of Regulation. October 16, 2009, page 23 available at <https://www.sec.gov/news/p/ress/2009/cftcjointreport101609.pdf>.

cannot—interpret the absence of this provision to mean Congress would still prefer the Commission had that narrow tool. While the economic purpose test might be a good test, it is not appropriate for the Commission to require here and at this time without a change to the law or, at the very least, a notice-and-comment rule on the books.

In question 9, the Commission asks if the economic consequences of Congressional control are predictable enough for a contract based on that control to serve a hedging function. It further asks for examples of commercial activity that can be *directly* hedged via the proposed contracts. Again, the Commission is implementing too narrow of a standard for hedging utility of event contracts or of futures contracts writ large. Changes in *general risk* can provide a strong hedging need as opposed to the changes in risk of a specific outcome. If one party were to take over complete control of Congress, there is likely to be a change in *general risk* on carbon-based energy products and industries and an opposite change in *general risk* on renewable energy products and industries. While the specific policies implemented may be hard to know in advance, that change in *general risk* has been discussed at length in comment letters and is hedged extensively by larger institutions through complex products.²² For example, following the election of Republicans into Congress in 2016, many publications speculated that trade policy would become more restrictive; but, it was not known if this would come in the form of new but restrictive trade deals, re-negotiating existing trade agreements, new tariffs (and if so, on what goods and at what level), international lawsuits, and more. The general risk, however, of future restrictive trade policy to those industries, firms, and individuals heavily exposed to foreign trade existed concretely and directly because of who would win the election. This risk is exactly what Kalshi's contracts allow traders to hedge.

In question eleven, the Commission makes the same mistake when it asks if the contract could “form the basis of pricing a commercial transaction in a physical commodity, financial asset, or service”. Not only is this language from the discarded economic purpose test, this question also excludes a price-forming impact on other futures contracts, such as other event contracts themselves. If it is in the public interest to list an event contract on potential tax rates two years from now, that contract's price would have an embedded probability of which parties control Congress at that time. Eliciting that probability through a market-based event contract directly on the political control of each chamber would serve a valuable price discovery function for a tax-rate contract as well as other policy-related contracts. It is unfortunate the Commission discarded this valuable price-basing use case from the question's list.

The economic purpose test represented through this question is too narrow for other reasons. In the *Nadex* decision, the Commission acknowledged this by suggesting it could consider other factors in its decision regarding public interest. These other factors, which should be considered

²²Public comment on Kalshi's proposal by **Angelo Lisboa**. Available here: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69662&SearchText=angelo>

here as well, are actually reasons to support the contract, not oppose it. A market-based probability of election outcomes would provide an extremely valuable public service, and act as a competitor to polls and paid pundits. This is sorely needed in American politics and it is exactly why one of the comment letters supporting Nadex's proposal was authored by a host of economists led by the late Nobel Laureate Kenneth Arrow.²³ Many of Kalshi's comment letters testify to the contract's public and academic value.^{24 25} Former Chair of the Council of Economic Advisors, Jason Furman, even testified that such markets were used in the White House when analyzing policy and its outcomes.²⁶

Kalshi's contracts depend on an economically important commodity and have obvious and widespread hedging and price-basing utilities, as well as other benefits

The economic impact of politics is plain and undeniable. Though it is not required to, Kalshi provided dozens of pages to the Commission and its staff detailing the contract's hedging and price basing utilities that cited much of the deep research on the link between elections, commercial risk, and the prices of financial assets. Investment banks frequently provide such hedging recommendations to their clients, and academic research repeatedly confirms that markets price election risk, with repricing occurring as polls change. Although the outcomes of Congressional control are never truly known, the market is already engaging in significant hedging and pricing behavior and testifies as much.

Other public comments, such as those by members of industry (like that of Angelo Lisboa, a Managing Director at JPMorgan Chase; or Jorge Paulo Lemann, a board member of AB InBev, Kraft Heinz, and Gillette)²⁷²⁸, politically sensitive businesses (Greenwork)²⁹, and academics and former government officials (former CEA Chair and current Harvard Professor Jason Furman, Aaron Director Lecturer in Law & Economics at The University of Chicago Law School Dr. Richard Sandor, former CFTC Commissioner and Acting Chairman Mark Wetjen, and former

²³ Public comment on Nadex's political event contracts. Available here: <https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/documents/ifdocs/ericzitzewitzltr020312.pdf>

²⁴ Public comment on Kalshi's proposal by **Alex Tabarrok**. Available here: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69697&SearchText=alex>

²⁵ Public comment on Kalshi's proposal by **Michael Gibbs**. Available here: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69704&SearchText=>

²⁶ Public comment on Kalshi's proposal by **Jason Furman**. Available here: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69708&SearchText=>

²⁷ Public comment on Kalshi's proposal by **Angelo Lisboa**. Available here: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69662&SearchText=angelo>

²⁸ Public comment on Kalshi's proposal by **Jorge Paulo Lemann**. Available here: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69684&SearchText=jorge>

²⁹ Public comment on Kalshi's proposal by **Sam Steyer**. Available here: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69677&SearchText=greenwork>

SEC Commissioner and Stanford Professor Emeritus Joseph Grundfest, as well as others)^{30 31 32 33} repeatedly discuss extant market risk stemming from changes in partisan control of Congressional chambers and the ways that Kalshi's contract would create risk mitigation opportunities and foster important price discovery.

In Conclusion

The Commission is heavily, and appropriately, constrained by the narrow language of the statute as well as an implemented regulation with debatable validity.³⁴ None of the statutory language nor the Commission's regulations address many of the questions the Commission poses here in evaluating these contracts. A government agency can also not deny a proposal by relying on authorities or frameworks it wishes it had or any internal or external promises to redo any existing regulations to create a different and clearer framework in the future. The Commission has the statute at hand and the regulations it has passed to deal with the proposals currently before it.

A credible regulator also cannot continue to rely on varying and disprovable conjectures to impose value judgments on an ad hoc basis. From potential cherry picked state laws (which are inconsistent, broad, and would be preempted by any Commission action), to an improvised, imprecise, and non-Administrative Procedure Act-based definition of "gaming" (which, if applied widely, would cut out large swaths of valuable futures market activity), to imposing a narrow and changing economic purpose standard found nowhere in the statute nor ever clearly defined by Commission regulations (which would give the Commission unlimited authority over major questions and put the onus on Exchanges instead of the agency), no such excuses have any legal merit.

While it may seem difficult to overturn prior precedent, I believe the analysis is actually very straight forward. Given the enormous extant evidence provided—well in excess of legal requirement—the Commission needs to fully engage with Kalshi's proposed contracts and approve them. If it does not believe that the market would find these to be useful hedging and price basing tools, despite market participants', esteemed academics', and former government officials' repeated testimony, it should provide its reasoning in detail pursuant to its existing authorities and regulations rather than dismiss the contract out of hand. Businesses, especially

³⁰ Public comment on Kalshi's proposal by **Jason Furman**. Available here: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69708&SearchText=>

³¹ Public comment on Kalshi's proposal by **Dr. Richard Sandor**

³² Public comment on Kalshi's proposal by **Mark Wetjen**. Available here: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70771>

³³ Public comment on Kalshi's proposal by **Joseph Grundfest**. Available here: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69695&SearchText=grundfest>

³⁴ See Statement of Commission Brian D. Quintenz on ErisX RSBIx NFL Contracts and Certain Event Contracts (Mar. 25, 2021), "Any Given Sunday in the Futures Market," available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/quintenzstatement032521>

ones that have long-term engagement with regulators, deserve to have a consistent and repeatable framework by which they can operate their firms in accordance with the law and regulations.

I thank you for your consideration of these comments and for doing the hard work of the Commission.

Sincerely,

A handwritten signature in black ink, appearing to read "B. Quintenz", with a horizontal line underneath.

Brian D. Quintenz

This comment is on behalf of Temper, one of America's leading health and nutrition startups. Specifically, Temper sells a novel cannabinoid mint for diet management. Election contracts would allow Temper to reduce its risk exposure to federal elections, and would thus be a welcome addition to the event contracts space.

As a company that sells a product that involves cannabinoids, federal policy is a key determinant of our success. The lack of clarity at a federal level for hemp and cannabinoids has made securing financing, customers, corporate partnerships and advertising more difficult than it otherwise would be. Large financiers—such as pension funds and sovereign wealth funds—are reluctant to invest money in a company that could face crackdowns in the face of a hostile new government. Without regulatory clarity, taking the next step to becoming an even larger company is difficult. However, it is abundantly clear the differences between the two parties on cannabis policy. The Democratic Party is far more sympathetic to complete legalization, and hostile to enforcement efforts. In contrast, the Republican Party is much more critical. The odds of complete legalization and regulatory clarity substantially fall if the Republican Party gained control of at least one house of Congress. Notably, the harms manifest to a company like ours even before any policy action is taken, as financiers and corporate partners may be skittish in *anticipation* of potential action. As a result, the outcomes of Congressional control are more than sufficiently predictable for us to use the product for its hedging purposes.

In addition, as we plan to take the next steps in our business, the probabilities generated by the contract's prices could be powerful inputs. Who is in power come January 2023 might affect our expansion plans, our growth strategy, and beyond. Having a market-driven data point that updates rapidly and is not subject to ideological bias could be helpful in facilitating the best decision-making process possible.

For thousands of companies, including our own, Congressional control is no game. It is a real threat to our business's bottom line the same way a public health emergency or a natural disaster or an economic downturn might be a threat to other businesses. We should be able to access the same tools to manage those risks, as we can manage those others. Dismissing this valuable product on the grounds that it could be used for gaming, or cannot be used for hedging, would fly in the face of the experience of our company and many others. We would suggest kindly that the Commission allow the contract to move forward.



September 24, 2022

By Electronic Submission

Mr. Christopher Kirkpatrick, Secretary
Commodity Futures Trading Commission
Three Lafayette Center
1155 21 Street NW
Washington, DC 20581

Re: Comments on KalshiEx, LLC's Proposed Congressional Control Contracts

Commissioners:

We sincerely appreciate the opportunity to comment on the submission by KalshiEx, LLC of its proposed Congressional control contracts for Commission review and approval. The question of election event contracts raises important issues of both law and public policy, and we commend the Commission for recognizing their importance and seeking public input.

We submit this comment on behalf of an anonymous client with a deep interest in the lawfulness of election event contracts.

We believe the Commission has a sound basis in law and policy for approving Kalshi's proposed contracts. As to the law, we believe that election event contracts like Kalshi's do not "involve gaming" under Section 5c(c)(5)(C) of the Commodity Exchange Act (CEA) or Rule 40.11 of the Commission's regulations, and so are not proscribed by those provisions. In addition, we believe that Rule 40.11, properly understood in light of the CEA and the Administrative Procedure Act (APA), affords the Commission discretion to approve election event contracts even if those contracts do "involve gaming." Finally, as to policy, we believe election event contracts promote the public good by, among other things, enhancing the accuracy of political predictions, promoting new forms of democratic participation, and serving as an economic hedge for both firms and individuals. We thus encourage the Commission to approve Kalshi's proposed contracts.

I. Section 5c(c)(5)(C) and Rule 40.11 Do Not Apply to Election Event Contracts.

Under the CEA, the Commission must approve contracts submitted to it unless the Commission affirmatively finds that they violate the CEA or the Commission's regulations. 7 U.S.C. § 7a-2(c)(5)(B); 17 C.F.R. § 40.3(b). The Commission has expressed concern that election event contracts may conflict with Section 5c(c)(5)(C) of the Act and Rule 40.11, which

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together prohibit event contracts based on gaming, four other enumerated activities, or “other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.” But an election is not gaming, nor any of the other four prohibited activities, nor a “similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.” Thus, Kalshi’s contracts are lawful and should be approved.

The Commission previously found an election event contract to be gaming because the contract itself was a form of gaming. *N. Am. Derivatives Exch., Inc. (Nadex)*, slip op. at 3 (CFTC Apr. 2, 2012). Respectfully, we believe the Commission erred in that Order and should not adhere to that position here. Section 5c(c)(5)(C) and Rule 40.11 prohibit event contracts where the event on which the event contract is based is an act of gaming. They do not prohibit event contracts simply because entering into the contract might itself be construed as a form of gaming. Indeed, as explained below, *all* event contracts involve making predictions (and related wagers) about future “occurrences” that are outside of the relevant parties’ control. Were this facial similarity with “gaming” all that were required to fall within Section 5c(c)(5)(C)’s reach, every event contract would be implicated—a plainly untenable result. Moreover, even if considered under the *Nadex* Order’s framing, an election event contract is still not gaming. “Gaming” has a well-established and precise meaning: betting on games of chance. An election is not a game of chance—or even a game at all—so staking money on an election is not gaming. Finally, at the very least, Section 5c(c)(5)(C) and Rule 40.11 do not clearly prohibit election event contracts and several traditional canons of construction weigh against construing them to do so here.

A. Standard of Review.

The meaning of the Commodity Exchange Act and the Commission’s regulations is a question of law to be answered using “the traditional tools of construction.” *Kisor v. Wilkie*, 139 S. Ct. 2400, 2415 (2019) (cleaned up). In particular, the Commission must apply these provisions according to their “ordinary meaning.” *Wis. Cent. Ltd. v. United States*, 138 S. Ct. 2067, 2070 (2018) (citation omitted). The term “gaming” in Rule 40.11(a) comes from Section 5c(c)(5)(C)(i)(V) of the CEA without alteration. Thus, even if genuine ambiguity remains after applying the traditional tools of construction, the Commission still must apply the term’s ordinary meaning. *See Kisor*, 139 S. Ct. at 2417 n.5 (an agency does not receive “deference” when it “interprets a rule that parrots the statutory text”).

B. An Election Event Contract Is Based on an Election—Not Gaming or Any Other Prohibited Activity.

Under the CEA, an event—that is, an “occurrence, extent of an occurrence, or contingency” outside of the relevant parties’ control—can be an excluded commodity that



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forms the basis of a contract. 7 U.S.C. § 1a(19)(iv). Under Section 5c(c)(5)(C)(i) of the Act, the Commission may determine that an event contract is contrary to the public interest if the contract “involve[s]” an event falling within one of six categories: “activity that is unlawful under any Federal or State law,” “terrorism,” “assassination,” “war,” “gaming,” and “other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.” *Id.* § 7a-2(c)(5)(C)(i). Contracts that the Commission finds to be against the public interest are prohibited. *Id.* § 7a-2(c)(5)(C)(ii). Rule 40.11 provides that any contract “based upon an excluded commodity ... that involves, relates to, or references” the first five categories is prohibited. 17 C.F.R. § 40.11(a)(1).

These provisions are best read to exclude election event contracts. Elections are not games and so cannot be seen as gaming. Nor can the election event contract itself supply the requisite “gaming,” as that would upend the statutory scheme by converting every event contract into “gaming.” After all, every event contract is based on an uncertain future occurrence. Such an interpretation of “gaming” would thus, in turn, read out of the statute the other terms in Section 7a-2(c)(5)(C)(i)—“war,” “assassination,” etc—because each would be “gaming” under that view. Such an interpretation is not plausible, as detailed further below.

1. *The Statutory and Regulatory Text Shows That Election Contracts Are Based on Elections Rather Than Gaming or Other Prohibited Activities.*

An election for public office is not any of the activities enumerated in Section 5c(c)(5)(C)(i). It is (obviously) not an unlawful activity, terrorism, assassination, or war. But neither is it gaming. “Gaming” is the playing of “games of chance for money.” *Game, New Oxford American Dictionary* (3d ed. 2010). Unlike dice, roulette, and other games of chance, elections are not primarily decided by pure luck; they are decided by the voters’ deliberate choices as to who should hold the public office in question. And even more fundamentally, elections are not “games” in the first place. They are not “engaged in for diversion or amusement,” *Game, Merriam-Webster’s Collegiate Dictionary* (11th ed. 2020), but to determine who will occupy political offices across the country. Finally, an election also does not fall within the final category of a “similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest,” 7 U.S.C. § 7a-2(c)(5)(C)(i)(VI), as elections are not similar to unlawful activities, terrorism, assassination, war, or gaming. Section 5c(c)(5)(C) and Rule 40.11 are thus best read as not outlawing election event contracts.

The Commission’s *Nadex* order took a different approach, asking instead whether “the contract, considered as a whole,” constitutes gaming. Slip op. at 2. Respectfully, we believe that this analysis misconstrues the word “involve” in the Act. Section 5c(c)(5)(C) gives the



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Commission the power to ban contracts that “involve” gaming—not contracts that might be seen as *themselves* constituting gaming when “considered as a whole.” Specifically, the CEA and the Commission’s other regulations consistently use the term “involve” to identify the commodity (event) on which the contract is based.¹ For purposes of the Act, an event contract thus “involves” gaming when the contract is based on a gaming event.

Rule 40.11 confirms as much. The Rule is titled: “Review of event contracts *based upon* certain excluded commodities.” 17 C.F.R. § 40.11 (emphasis added). And its text prohibits any “[a]greement, contract, transaction, or swap *based upon* an excluded commodity, as defined in Section 1a(19)(iv) of the Act, that involves, relates to, or references ... gaming.” *Id.* (emphasis added). The Rule is thus clear that the contract must be “based upon” the particular excluded commodity rather than itself being part of that commodity. In other words, the contract must be based upon gaming rather than the contract itself constituting gaming.

Thus, an event contract that turns on whether a winner will be announced at the next Mega Millions Lottery drawing “involves” gaming within the meaning of the Act, because such a contract is based on a gaming event—a lottery is a game of chance played for money. In contrast, an event contract that turns on the performance of a particular harvest, sector of the energy industry, or election for public office does not “involve” gaming within the meaning of the Act, because that sort of contract is *not* based on a game of chance. Contrary to *Nadex’s* reasoning, it is not dispositive—indeed, it cannot be dispositive—that entering into an event contract might be akin to gaming in some sense (*i.e.*, staking money or other resources on the occurrence of a future event that is outside of the relevant parties’ control). *See* slip op. at 2 & nn. 1 & 2. After all, every event contract shares this characteristic. Such an interpretation of Section 5c(c)(5)(C) would thus preclude entering into *any* event contract under the CEA and Rule 40.11—an outcome that is self-evidently untenable, as explained at

¹ *See, e.g.*, 7 U.S.C. § 6c(b) (“No person shall offer to enter into ... any transaction involving any commodity”); *id.* § 15b(e) (“Each cotton futures contract ... shall be in writing plainly stating ... the terms of such contract , including the quantity of the cotton involved”); *id.* § 16(e)(1)(B) (“Nothing in this chapter shall supersede or preempt ... the application of any Federal or State statute ... to any transaction in or involving any commodity”); *id.* 23(b)(1) (“The Commission may set different terms and conditions for transactions involving different commodities.”); 17 C.F.R. § 1.17(c)(5)(iii)(C)(1)(iii) (“In the case of over-the-counter swap transactions involving commodities, 20 percent of the market value of the amount of the underlying commodities.”); *id.* § 5.9(d) (“A major currency pair security deposit percentage is only applicable when both sides of a retail over-the-counter foreign exchange transaction involve major currencies.”); *id.* § 31.8(a)(2)(ii) (“Permissible cover for a long leverage contract is limited to: ... one type of bulk gold coins for leverage contracts involving another type of bulk gold coins”).



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greater length below.

2. *The Statutory and Regulatory Context Confirms That Election Contracts Are Based on Elections Rather Than Gaming or Other Prohibited Activities.*

Context confirms that Section 5c(c)(5)(C)(i) and Rule 40.11 are best understood to not reach election event contracts. By their terms, these provisions apply only to contracts that are based on an excluded commodity that is an event outside the contracting parties' control.² Likewise, the other listed activities are events outside the parties' control. An event contract cannot *itself* constitute an act of terrorism, assassination, or war, whereas such acts *can* be the excluded commodities that underly an event contract. It would be very strange if gaming were the only term in Section 5c(c)(5)(C)(i) that referred to the nature of the entire contract rather than to the underlying excluded commodity.

Construing “gaming” to include both the underlying occurrence and the contracts on that occurrence would, moreover, make the other subsections of Section 5c(c)(5)(C) surplus. After all, event contracts on whether New York City will be bombed in October (“terrorism”), whether Kim Jong Un will be killed (“assassination”), or whether Ukraine will defeat Russia (“war”) are all equally bets on the outcomes of future events. Each of these could simply be prohibited as a “gaming” contract under the reasoning in the Commission’s *Nadex* Order. Indeed, the broad *Nadex* construction would even risk supplanting the catchall provision for “any other similar activity” the Commission identifies “by rule or regulation,” 7 U.S.C. § 7a-2(c)(5)(C)(i)(VI), since *any* event contract could be prohibited as “gaming” under that view. That is not plausible.

Finally, although we do not believe the Commission should rely on Section 5c(c)(5)(C)’s legislative history to interpret Section 5c(c)(5)(C),³ it too supports the view that election event

² Section 5c(c)(5)(C)(i) refers to commodities described in “section 1a(2)(i) of this title,” a provision which does not exist, rather than Section 1a(19)(iv), which defines when an occurrence or contingency is an excluded commodity. That is a scrivener’s error, as Rule 40.11 recognizes. See 17 C.F.R. 40.11(a)(1) (referring to commodities “defined in Section 1a(19)(iv)”). And that definitional provision defines “excluded commodity” to include, in relevant part, “an occurrence ... beyond the control of the parties to the relevant contract, agreement, or transaction; and associated with a financial, commercial, or economic consequence.” 7 U.S.C. § 1a(19)(iv)(I)–(II).

³ As the Supreme Court has explained, “legislative history is not the law”; statutory interpretation must instead be based on “statutory text” and “structure.” *Azar v. Allina Health Servs.*, 139 S. Ct. 1804, 1814 (2019) (cleaned up).



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contracts are not gaming. When asked about the scope of the Commission's power to ban gaming contracts, Senator Lincoln replied that it would cover event contracts based on "sporting events such as the Super Bowl, the Kentucky Derby, and Masters Golf Tournament." 156 Cong. Rec. S5907 (daily ed. July 15, 2010). All these examples are contracts where the underlying commodity is the outcome of a game, which an election is not.

C. An Election Event Contract Is Not Itself Gaming.

But even if the *Nadex* Order were correct to consider the contract as well as the underlying commodity, we respectfully submit that the Order was still mistaken to apply that reasoning to election event contracts. Event contracts based on the outcome of an election might be *wagers*, but not all wagers are *gaming*. "Gaming" refers to placing stakes on the outcome of a game of chance. And as noted above, an election is not a game of chance, a game of skill, or even a game at all.

The ordinary meaning of the word "gaming" is betting on games of chance. See *Gaming*, *Oxford English Dictionary* (3d ed. 2013) ("To take part in an indoor game, of a kind on which stakes or wagers may be placed; *esp.* to play games of chance for such stakes or wagers"); *Game*, *New Oxford American Dictionary*, *supra* ("play games of chance for money"); *Game*, *Webster's Third New International Dictionary* (1961) ("to play for a stake (as with cards, dice, or billiards)"); *Gaming*, *The Cambridge Advanced Learner's Dictionary* (4th ed. 2013) ("the risking of money in games of chance, especially at a casino"). Hence courts have long recognized that "betting is not gaming unless the wager be laid upon a game." *In re Opinion of the Justs.*, 63 A. 505, 507 (N.H. 1906). Had Congress wanted to sweep more broadly, it could have used the more common term "gambling," which encompasses bets on both games of chance *and* "the outcome of particular events" more generally. *Gambling*, *Oxford English Dictionary*, *supra*. Indeed, the statutes relied upon in the *Nadex* Order to support a purported "link" between "gaming" and "betting on elections" mostly use the broader term "gambling," not "gaming." See slip op. at 2 & n. 1.

For contracts to constitute "gaming," there must thus be underlying games of chance. Elections are not games, let alone games of chance. Election event contracts are thus best understood to not constitute gaming.

D. Section 5c(c)(5)(C) and Rule 40.11 Do Not Clearly Prohibit Election Event Contracts.

We further believe that four traditional tools of construction weigh against the Commission applying Section 5c(c)(5)(C) and Rule 40.11 to election event contracts: the federalism canon, the major questions doctrine, the presumption of validity, and the rule of



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lenity. For the reasons detailed above, we do not believe these provisions are best read to include election event contracts. But at a minimum, they do not clearly include election event contracts. The Commission acknowledged as much when promulgating Rule 40.11, noting that “the term ‘gaming’ requires further clarification” and may not extend beyond “participation in traditional ‘gaming’ activities.” Final Rulemaking, 76 Fed. Reg. 44,776, 44,785 (July 27, 2011). Accordingly, the Commission should not interpret these provisions to prohibit election event contracts.

1. *The Federalism Canon and the Major Questions Doctrine*

The Federalism canon provides that Congress must “enact exceedingly clear language if it wishes to significantly alter the balance between federal and state power.” *Ala. Ass’n of Realtors v. HHS*, 141 S. Ct. 2485, 2489 (2021) (citation omitted). Likewise, under the major questions doctrine, the Supreme Court has explained that Congress must “speak clearly if it wishes to assign to an agency decisions of vast economic and political significance.” *West Virginia v. EPA*, 142 S. Ct. 2587, 2605 (2022) (citation omitted). We believe that both principles are implicated here.

The regulation of gambling has long been “the particular domain of state law.” *Ala. Ass’n*, 141 S. Ct. at 2489. As a government of enumerated powers, the federal government does not possess a “general police power,” which is instead “retained by the States.” *United States v. Lopez*, 514 U.S. 549, 567 (1995). Legislation “to protect the public morals” lies at the core of the police power. *Chi., B. & Q. Ry. Co. v. Illinois*, 200 U.S. 561, 592 (1906). And gambling laws are quintessential public morals legislation. *See Murphy*, 138 S. Ct. at 1469. Hence, the lawfulness of gambling has long been a question of state law. *See id.* at 1468–71. The “general federal approach” has been to prohibit certain interstate activities related to gambling, but “only if that conduct is illegal under state or local law.” *Id.* at 1483; *see* 18 U.S.C. §§ 1084, 1952, 1953, 1955; 31 U.S.C. § 5363.

The regulation of gambling is also a matter of vast political and economic significance. Gambling is both a “controversial issue” and an “immensely popular” pastime, *Murphy*, 138 S. Ct. at 1469, 1483, which involves a great deal of money. In 2020, for instance, customers of a single British betting company collectively staked £434 million (about \$566 million) on the outcome of the U.S. presidential election. T. Adinarayan & D. Chowdhury, *Bettors Stampede Back in Favor of Biden as Results Stream in*, *Nat’l Post* (Nov. 4, 2020), <https://tinyurl.com/4w54t2dk>. If the Commission interprets “gaming” broadly, the size of the economic activity implicated will naturally be even greater. *See Ala. Realtors*, 141 S. Ct. at 2489 (evaluating the “majorness” of a question by the larger consequences of the agency’s assertion of authority, not merely the consequences of the specific outcome it is defending).



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Given these considerations, the Commission should not read Section 5c(c)(5)(C) to require that it ban event contracts which do not involve traditional gaming activities, *i.e.*, games of chance. If Congress had wished to confer that authority on the Commission, it would have said so explicitly.

2. *The Presumption of Validity*

Under the presumption of validity, an “interpretation that validates outweighs one that invalidates.” Scalia & Garner, *supra*, at 66. Accordingly, the Commission should not adopt an interpretation of Rule 40.11 that would place it in conflict with Section 5c(c)(5)(C) or the APA if another interpretation is fairly possible. *Cf. Jennings v. Rodriguez*, 138 S. Ct. 830, 836 (2018) (applying the same principle for a statute vis-à-vis the Constitution). Because reading Rule 40.11 to cover election event contracts would place it in conflict with those statutes, we respectfully submit that the Commission should not read it to apply beyond contracts involving games of chance.

Section 5c(c)(5)(C) empowers the Commission to prohibit contracts involving gaming only by “determin[ing]” that such contracts are “contrary to the public interest.” 7 U.S.C. § 7a-2(c)(5)(C)(i), (ii). And the APA requires the Commission to give a reasoned explanation for its determination. 5 U.S.C. § 706(2)(A); *Motor Vehicle Mfrs. Ass’n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 48 (1983). In issuing Rule 40.11, the Commission noted that the term “gaming” may not extend beyond “participation in traditional ‘gaming’ activities” and that it would “continue[] to consider” whether there are “bases for distinguishing” such activities from “trading in contracts linked to the occurrence (or non-occurrence) of events.” Final Rulemaking, 76 Fed. Reg. at 44,785. The Commission thus never determined that election event contracts or other event contracts that are not traditional gaming activities are contrary to the public interest. Still less did it give a reasoned explanation for such a determination. If Rule 40.11 covers these event contracts, then it conflicts with Section 5c(c)(5)(C) and is arbitrary and capricious under the APA. The rule should thus instead be read to apply only to contracts involving games of chance.

3. *Rule of Lenity*

Where “a reasonable doubt persists” about the scope of a penal provision, the provision must be construed not to impose liability. *Moskal v. United States*, 498 U.S. 103, 108 (1990). A penal provision is one whose violation may be punished with a civil or criminal penalty. *See Wooden v. United States*, 142 S. Ct. 1063, 1086 & n.5 (2022) (Gorsuch, J., concurring in the judgment) (collecting authorities); Scalia & Garner, *supra*, at 297. Section 5c(c)(5)(C) and Rule 40.11 implicate both kinds of penalty. The Commission may civilly punish a registered entity that violates Rule 40.11 with suspension or revocation of its registration. 7 U.S.C.



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§ 7b. And any person who willfully violates Rule 40.11(a) is guilty of a felony. *Id.* § 13(a)(5). Nor does it matter that the Commission does not seek to punish Kalshi in this proceeding. “The rule of lenity ... is a rule of statutory construction whose purpose is to help give authoritative meaning to statutory language.” *United States v. Thompson/Ctr. Arms Co.*, 504 U.S. 505, 518 n.10 (1992). As such, it always applies to a penal provision, even when the provision is being applied in a nonpenal context. *Id.* Once the rule of lenity is applied, Section 5c(c)(5)(C) and Rule 40.11 are best understood to not cover election event contracts, given the Commission’s own stated doubt concerning whether contracts involving “gaming” include wagers on events that are not games of chance or even games.

II. Section 5c(c)(5)(C) and the APA Require an Individualized Public-Interest Determination in This Proceeding.

If the Commission nevertheless determines that Rule 40.11 applies to election event contracts, then we believe it should interpret that Rule as giving it discretion to nonetheless approve them—an approval it should grant for the reasons detailed in Part III below. Section 5c(c)(5)(C) and the APA are best understood as requiring case-by-case determinations by the Commission for contracts falling in the enumerated categories. That means the Commission must make a public-interest determination and give a reasoned explanation for such a determination here. This is especially true in light of the fact that the Commission has not yet determined whether gaming generally or Kalshi’s contracts in particular are contrary to the public interest nor given a reasoned explanation for any such determination.

A. Section 5c(c)(5)(C) Requires an Individualized Public-Interest Determination.

Under Section 5c(c)(5)(C), the Commission must decide whether contracts involving gaming are contrary to the public interest on a case-by-case basis. The statute is best understood to not permit a categorical determination that such contracts are always contrary to the public interest.

Start with the relevant text of Section 5c(c)(5)(C)(i):

In connection with the listing of agreements, contracts, transactions, or swaps in excluded commodities that are based upon the occurrence, extent of an occurrence, or contingency ... by a designated contract market or swap execution facility, the Commission may determine that such agreements, contracts, or transactions are contrary to the public interest if the agreements, contracts, or transactions involve ... gaming.



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7 U.S.C. § 7a-2(c)(5)(C)(i). The Commission may make a public-interest determination only “[i]n connection with the listing of agreements, contracts, transactions, or swaps ... by a” registered entity. *Id.* That is, the determination must be *in response to* a registered entity listing a contract involving gaming. Moreover, the determination applies to “*such* agreements, contracts, or transactions ... if *the* agreements, contracts, or transactions involve” gaming. *Id.* (emphases added). When used as an adjective, “such” refers to particular things already mentioned. *See Such, Oxford English Dictionary, supra* (“The previously described or specified; the (person or thing) before mentioned.”); *Such, Black’s Law Dictionary* (11th ed. 2019) (“That or those; having just been mentioned”). The use of the definite article also indicates that the clause speaks of particular contracts, not contracts involving gaming generally. And the verb “determine” offers further support: It carries an adjudicative connotation, suggesting a case-by-case decision. *See Determine, Black’s Law Dictionary, supra* (“The act of deciding something officially; esp., a final decision by a court or administrative agency”); *Determine, Oxford English Dictionary, supra* (“To settle or decide (a dispute, question, matter in debate), as a judge or arbiter.”).

Zooming out, the sentence structure of Section 5c(c)(5)(C) would be awkward and redundant if it was meant to refer to contracts involving gaming generally. Had that been Congress’s intent, it could simply have said, “The Commission may determine that agreements, contracts, or transactions that are based on certain excluded commodities ... are contrary to the public interest if they involve gaming.”

Moreover, another clause of Section 5c(c)(5)(C), which addresses the clearing of swaps, uses the same sentence structure to unambiguously require an individualized determination:

In connection with the listing of a swap for clearing by a derivatives clearing organization, the Commission shall determine, upon request or on its own motion, the initial eligibility, or the continuing qualification, of a derivatives clearing organization to clear such a swap under those criteria, conditions, or rules that the Commission, in its discretion, determines.

7 U.S.C. § 7a-2(c)(5)(C)(iii)(I) (emphases added). A single derivatives clearing organization’s “initial eligibility” and “continuing qualification” can only be individualized determinations. And the Commission’s implementing regulation recognizes as much. *See* 17 C.F.R. § 39.5 (outlining process for reviewing swaps on an individualized basis).

In addition, Section 5c(c)(5)(C)(iv)’s deadline makes sense only if it refers to an individualized determination. “The Commission shall take final action under clauses (i) and (ii) in not later than 90 days from the commencement of its review unless *the party* seeking to offer *the contract or swap* agrees to an extension of this time limitation.” 7 U.S.C. § 7a-



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2(c)(5)(C)(iv) (emphases added). This language is best understood as acknowledging that a determination under Section 5c(c)(5)(C)(i) concerns a specific contract brought by a specific party. Thus, “final action” under that provision cannot be the issuance of a rule of general applicability. On top of that, a 90-day deadline is likely too short in the context of notice-and-comment rulemaking. For instance, two hundred sixty-seven days elapsed between the Notice of Proposed Rulemaking (NPRM) and the Final Rulemaking for Rule 40.11.

Finally, Rule 40.11 assumes that the Commission will determine the public interest on a case-by-case basis. While Rule 40.11(a)(1) may seem like a categorical prohibition when read in isolation, Rule 40.11(c) provides that the Commission can prohibit a contract involving gaming only after public notice and a 90-day review period. That would be quite unnecessary if the Commission only needed to decide whether a contract involved gaming, which would be cut and dry in many cases. *See infra* Part III.A (discussing Rule 40.11(c) further).

But even if the statute could be read to empower the Commission to categorically prohibit every contract that “involves” gaming, we submit it would exceed the statute’s scope to prohibit every contract that merely “relates to” or “references” gaming. 17 C.F.R. 40.11(a)(1). Section 5c(c)(5)(C) allows the Commission to prohibit only contracts that “involve” gaming. 7 U.S.C. § 7a-2(c)(5)(C)(i). Rule 40.11 is best understood as staying within that statutory constraint and as not expanding the Commission’s power beyond contracts “involving” gaming, as detailed in Part I above.

B. The Commission Has Not Yet Made an Applicable Public-Interest Determination.

Even if Section 5c(c)(5)(C) did not require an individualized public-interest determination, we respectfully submit that the Commission should make one here. The Commission can ban contracts involving gaming only if it first determines that such contracts are “contrary to the public interest.” 7 U.S.C. § 7a-2(c)(5)(C)(i), (ii). But the Commission has not yet made a public-interest determination that applies to Kalshi’s contracts.

Nor did the Commission determine that gaming contracts are always contrary to the public interest when it issued Rule 40.11. The text of Rule 40.11(a)(1) does not mention the public interest. Neither did the NPRM, which said only that Section 5c(c)(5)(C) “authorizes the Commission to prohibit” contracts involving gaming and that the Commission is acting “[p]ursuant to this authority.” 75 Fed. Reg. 67,282, 67,288–89 (Nov. 2, 2010). The Commission did mention the public interest in the Final Rulemaking, where it said that it “would like to note that its prohibition of certain ‘gaming’ contracts is consistent with Congress’s intent to ‘prevent gambling through the futures markets’ and to ‘protect the public



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interest from gaming and other events contracts.” 76 Fed. Reg. at 44,786 (quoting legislative history). But this is not a *determination by the Commission* that gaming contracts violate the public interest. It is an *observation* that *Congress* has found gaming contracts to be contrary to the public interest and that the Commission is simply complying with that finding. Although we appreciate the Commission’s desire to respect the will of Congress, Congress left it to “the Commission” to “determine” whether gaming contracts “are contrary to the public interest.” 7 U.S.C. § 7a-2(c)(5)(C)(i). But finally and besides, even if this discussion did amount to a public-interest finding, as discussed above, it was limited to “traditional ‘gaming’ activity,” which does not include election event contracts. Final Rulemaking, 76 Fed. Reg. at 44,785; *supra* Part I.D.2.

Appropriately, the Commission did make an individualized public-interest determination in its *Nadex* Order. Slip op. at 4. But that finding by its terms was limited to “the Political Event Contracts,” *id.*, the defined term the Commission used for the specific contracts *Nadex* had proposed in that proceeding, *id.* at 1. Naturally, the Commission’s finding was also based on the specific facts and arguments presented in that proceeding, which are not identical to the ones presented here. Accordingly, if the Commission determines that Kalshi’s contracts involve gaming—which, as discussed above, would be contrary to the ordinary meaning of both “involve” and “gaming”—we believe it should also make an individualized public-interest finding to conform to the requirements of Section 5c(c)(5)(C).

C. The Commission Has Not Yet Explained Any Applicable Public-Interest Finding.

For similar reasons, we believe the Commission should make a public-interest determination here to conform to the APA. The APA requires agencies to give reasoned explanations for their decisions. 5 U.S.C. § 706(2)(A). The Commission has not yet given a reasoned explanation on whether Kalshi’s contracts or gaming contracts generally are contrary to the public interest. To the contrary, the Commission acknowledged that it would “continue[] to consider” whether contracts involving events that are not “traditional ‘gaming’ activities” should be banned at all. Final Rulemaking, 76 Fed. Reg. at 44,785.

In addition, the APA requires the Commission “to appreciate the full scope of [its] discretion” when making decisions. *See DHS v. Regents of the Univ. of Cal.*, 140 S. Ct. 1891, 1911 (2020). When issuing Rule 40.11, the Commission appeared to believe that Congress had already determined that gaming contracts are contrary to the public interest. *Supra* Part II.B. We believe the Commission should acknowledge its discretion (and obligation) to make its own public-interest determination and exercise it.



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Moreover, even setting aside the text of Section 5c(c)(5)(C), we do not believe the legislative history of that provision justifies a determination that gaming contracts are contrary to the public interest. The Final Rulemaking discerned Congress's intent from a single colloquy by two Senators. Final Rulemaking, 76 Fed. Reg. at 44,786 & nn. 34–35 (citing 156 Cong. Rec. S5906–07 (daily ed. July 15, 2010) (statements of Sens. Lincoln and Feinstein)). But Congress does not speak authoritatively through legislative history, only through duly enacted statutes. *Allina Health Servs.*, 139 S. Ct. at 1814. And even when courts consult legislative history, they accept only “clear evidence of congressional intent.” *Milner v. Dep’t of Navy*, 562 U.S. 562, 572 (2011). Floor statements by individual Senators are not enough. Such statements “rank among the least illuminating forms of legislative history.” *NLRB v. SW Gen., Inc.*, 137 S. Ct. 929, 943 (2017); *accord Advoc. Health Care Network v. Stapleton*, 137 S. Ct. 1652, 1661 (2017).

III. Election Event Contracts Promote the Public Interest.

If the Commission determines that Kalshi's contracts involve gaming, we submit that the Commission retains the discretion to find that they are not contrary to the public interest. It should exercise that discretion to approve them.

A. Rule 40.11 Permits the Commission to Consider the Public Interest Here.

Nothing in the CEA or the Commission's regulations prohibit it from approving individual contracts that fall within Rule 40.11(a). Rule 40.11(a) forbids a “registered entity” to “list” for trading a contract that involves gaming (emphasis added). It says nothing about what the Commission can do. Rule 40.11(c) requires the Commission to “issue an order approving or disapproving” the contract by the end of the 90-day review period. But it does not identify the standard by which the Commission must approve or disapprove requests or otherwise limit the Commission's discretion in any other way. Thus, nothing in Rule 40.11 prevents the Commission from approving a contract involving gaming on the ground that the contract is consistent with the public interest. Nor does any provision of the CEA. To the contrary, the Act requires the Commission to determine the public interest on a case-by-case basis. 7 U.S.C. § 7a-2(c)(5)(C)(i); *supra* Part II.A.

B. The Predictive Value of Election Event Contracts Serves the Public Interest.

As the Commission recognized in its *Nadex* Order, the public-interest standard is not limited to the narrow question of whether a contract satisfies the economic purpose test. Slip op. at 4. Despite recognizing this general principle, the Commission has not yet publicly



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considered the benefits of election event contracts beyond whether it has an economic purpose. Such contracts have a separate and unique benefit to the public—they provide a mechanism for accurately predicting election results.

An academic study of the Iowa Electronic Markets found that the markets have “no obvious biases” in forecasting election results and have “considerable accuracy.” J. Berg et al., *Results from a Dozen Years of Election Futures Markets Research*, in 1 *Handbook of Experimental Economics Results* 742, 746 (Charles R. Plott & Vernon L. Smith eds., 2008). The Iowa Markets consistently outperform conventional polls, predicting presidential election results within 1.5%, compared to 1.9% on average for polls. *Id.* The Iowa Markets are also “more stable than polls over the course of election campaigns.” *Id.* at 747. And their prices “do not follow poll results”; rather, they “predict changes in polls.” *Id.* at 749.

More accurate predictions promote the public interest. Accurate information about the future is as vital to politics as to business. Politicians and the public both rely on predictions about elections in the form of polls and expert commentary to shape their behavior. Politicians use this information to understand whether their message is resonating with the public and to reshape it as needed. The public uses this information to know what candidates and events are worth paying attention to, and to make decisions as to how to most effectively allocate scarce resources. By providing more accurate predictions, election event contracts can only improve our democracy. The CEA recognizes that commodity futures trading serves the “national public interest by providing a means for ... discovering prices” and “disseminating pricing information through trading.” 7 U.S.C. § 5(a). Election events contracts provide an analogous public benefit in the political arena, in addition to the price-discovery benefits discussed below.

Election event contracts can be particularly useful in down-ballot races and for less-established candidates. National polling firms are less likely to conduct polls for district-level and local races. Whatever polling is conducted is less accurate, and campaigns have to spend money to conduct internal polling that is not released to the public. According to academic researchers, election prediction markets remain “extremely accurate” even at the district level. J. Wolfers & E. Zitzewitz, *Prediction Markets*, 18 *J. of Econ. Perspectives* 107, 112 (2004). Election event contracts would thus allow the public and candidates with lower levels of funding to have accurate predictions in races that would otherwise be neglected. Democratizing the availability of accurate predictive information for less well-funded candidates and races in smaller markets serves the ends of democracy by helping to level the playing field for these otherwise marginalized candidates and races.

Election prediction markets promote democratic values and expand participation in our democracy in additional ways. To obtain analysis of future election results today,



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members of the public largely have to rely on polls conducted by a small number of elite firms and a small class of expert commentators in the media. If election event contracts were to become more widespread, ordinary members of the public would be able to improve political discourse and learn from their fellow citizens through participation in prediction markets. Election event contracts have the power to harness the wisdom of the crowd and to open up a new avenue of political participation that would not otherwise exist.

The Commission's rationale in *Nadex* for concluding that the contracts at issue there harmed the public interest was that those contracts could create "monetary incentives to vote for particular candidates even when such a vote may be contrary to the voter's political view of such candidates." Slip op. at 4. Naturally, this would be concerning if it took place on a large scale, but it seems unlikely to occur in any given case. The effect of a single vote on any election is negligible, so any financial incentive to vote against one's political views would likewise be negligible. And to the extent someone tried to guarantee a favorable outcome on a contract by buying the votes of others, that would be a crime under federal law. 18 U.S.C. § 597.

C. Election Event Contracts Pass the Economic Purpose Test.

In any event, election event contracts serve the public interest even under the economic purpose test. In *Nadex*, the Commission asserted that "the unpredictability of the specific economic consequences of an election means that" the contracts *Nadex* had proposed "cannot reasonably be expected to be used for hedging purposes." Slip op. at 3. But the Commission did not explain its reasoning on this point, and there are good reasons to think otherwise.

First, on an intuitive level, it is easy to see how even one election result can have significant economic consequences for certain firms and individuals.⁴ Although there are many elected officials in America, much of the law governing business today comes in the

⁴ Many individuals have commented in this proceeding identifying consequences of elections against which election event contracts would allow them to hedge. See, e.g., Comment of Ian W., No. 69730 (Sept. 22, 2022) (explaining that Congress this term "was literally *one vote* away from changing the capital gains tax treatment" that applied to him); Comment of Valentin Perez, No. 69725 (Sept. 21, 2022) (as a small business owner, taxes and immigration policy); Comment of Jacob Faircloth, No. 69683 (Sept. 13, 2022) (explaining that the SALT deduction is unlikely to be fully restored in the near future unless the Democrats control Congress); Comment of Mike Ee, No. 69681 (Sept. 12, 2022) (explaining that changes to Medicare funding would affect the income of his wife, who works at a hospital); Comment of Amir K. Kaushik, No. 69656 (Sept. 5, 2022) (as an international student, immigration policy).



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form of regulations issued by administrative agencies. Administrative agencies largely answer to one person: the President. Presidential candidates can have starkly different positions on how certain industries should be regulated, meaning the outcome of the presidential election can have significant financial consequences for firms in those industries. Control of Congress, the subject of Kalshi's proposed contracts, has similarly observable consequences. Which party controls Congress after the midterms will determine whether the country will have a united or divided government for the next two years, and economically significant legislation favored by one of the two major parties is much more likely to pass under a united government. And on many issues, the major parties have clear differences in their platforms that party leaders ensure are followed once they are in power, so one can often foresee the sorts of policies a united government will enact into law.

Second, there is concrete empirical evidence of the economic impact of elections. One study, for instance, examined the equity prices of 41 firms whose activities would be favored under the policy platforms of George W. Bush and 21 firms favored under those of Al Gore in the wake of the 2000 presidential election. Brian Knight, *Are Policy Platforms Capitalized into Equity Prices? Evidence from the Bush/Gore 2000 Presidential Election 2* (Nat'l Bureau of Econ. Res., Working Paper No. 10,333, 2004). The study found a statistically significant effect: on average, the value of Bush-favored firms was 3% higher than they would have been under a Gore administration, while the value of Gore-favored firms was 6% lower. *Id.* at 9–10. The difference was more pronounced in industries where the difference in the candidates' policy views was greater. Tobacco firms, for instance, were worth 13% more under Bush relative to Gore. *Id.* at 11. For firms sensitive to regulation in areas where candidates have significant policy disagreement, election event contracts would easily be able to serve a hedging function.

* * * * *

We again thank the Commission for seeking public input on these important questions. We urge the Commission to approve Kalshi's proposed contracts because they do not involve gaming and are not contrary to the public interest.

Very truly yours,

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cc: The Honorable Rostin Behnam, Chairman
The Honorable Kristin N. Johnson, Commissioner
The Honorable Christy Goldsmith Romero, Commissioner
The Honorable Summer K. Mersinger, Commissioner
The Honorable Caroline D. Pham, Commissioner