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 5

JOINT APPENDIX UNDER RULE 7(n)
VOLUME 5

KALSHIEX LLC V. CFTC, NO. 1:23-CV-03257-JMC

Index of Joint Appendix Pursuant to Local Civil Rule 7(n)

To: Pujol Schott, Sebastian[sps@cftc.gov]
Cc: McGonagle, Vincent A.[vmcgonagle@CFTC.gov]; Jeffrey Bandman[jbandman@kalshi.com]
From: Eliezer Mishory[emishory@kalshi.com]
Sent: Wed 7/20/2022 11:59:06 AM (UTC-04:00)
Subject: [EXTERNAL] Contract Filed for Commission Review and Approval
CFTC Kalshi FOIA Request (contract filing).pdf
CONGRESS submission for DMO.pdf

Sebastian,
Apologies for the delay in responding to your email yesterday! We submitted the political control contract this morning under Commission Regulation 40.3, *Voluntary submission of new products for Commission review and approval*. If you have any questions or would like to discuss, please feel free to call me on my cell phone at any time. (443) 839-3192. Thank you again for all the engagement that you have given us on these issues; I really appreciate it!!

I thought it might be convenient for you to have the contract in a single document that includes internal links from the index for easier navigation. Because of the way the portal is set up, I couldn't submit this there, so I'm just emailing it here in case it's useful to you.
Warmly,
Elie
p.s. KalshiEX LLC requests FOIA confidential treatment for this email and the attachments, as noted in detail on the attached letter.

7/19/2022

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: KalshiEX LLC - Commission Regulation 40.3(a), *Voluntary submission of new products for Commission review and approval*, regarding the "Will <party> be in control of the <chamber of Congress>?" Contract

Dear Sir or Madam,

Pursuant to Section 5c(c) of the Commodity Exchange Act and Rule 40.3(a) of the regulations of the Commodity Futures Trading Commission, KalshiEX LLC (Kalshi or Exchange) hereby voluntarily submits the new "Will <party> be in control of the <chamber of Congress>?" 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 118th 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,

Elie Mishory
Chief Regulatory Officer
KalshiEX LLC
emishory@kalshi.com

KalshiEX LLC
Official Product Name: Will <party> be in control of the <chamber of Congress>?
Rulebook: CONGRESS
Kalshi Contract Category: Political Decision
Control of Congress
7/19/2022

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 40.3(a)(4), 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 <party> win <chamber of Congress>?" Contract (Contract) is a contract relating to the partisan control of Congress.

Contracts on political control of Congress available to US participants have been trading for nearly a decade. Since 2014, a similar contract has been available for trading on an unregistered trading venue that purports to operate under a No-Action Letter that was issued by the Division of Market Oversight in 2014 and granted relief to operate without complying with a number of aspects of the Commodity Exchange Act and Commission Regulations.

The Exchange is proposing to bring such contracts onto a fully regulated exchange operating under the core principles applicable to a DCM, with participant funds safeguarded at a DCO operating under the core principles applicable to a DCO. The Exchange believes it is time to offer these widely used but unregulated contracts on a fully regulated basis so that U.S. persons can hedge risks arising from political control on a market with robust safeguards and transparency.

In the 2018 cycle, the following contracts were traded, and had the following number of contracts traded[1], as stated by that unregistered trading venue:

• Control of the Senate	1,600,000 contracts traded

[1] The volume numbers in the following tables are rounded.

• Control of the House	4,600,000 contracts traded
• Control of Congress	2,900,000 contracts traded
• Number of Republican seats in the Senate	19,400,000 contracts traded
• Number of Republican seats in the House	8,100,000 contracts traded
• Number of Democrat seats in the House	6,300,000 contracts traded

In the 2020 cycle, the following contracts were traded, and had the following volume, as stated by that unregistered trading venue:

• Control of the Senate	13,800,000 contracts traded
• Control of the House	7,500,000 contracts traded
• Control of Congress	29,200,000 contracts traded
• Number of Democrat seats in the House	6,300,000 contracts traded

For the current cycle, the following contracts are trading, and had the following volume, as stated by that unregistered trading venue on July 19, 2022:

• Control of the Senate	1,300,000 contracts traded
• Control of the House	1,800,000 contracts traded
• Control of Congress	2,400,000 contracts traded
• Senate Majority Leader	183,000 contracts traded
• Speaker of the House	2,500,000 contracts traded

• Number of Republican seats in the Senate	1,700,000 contracts traded

In total, approximately 110,000,000 contracts have traded on political control on this unregistered trading venue[2] since the 2018 cycle.

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 Contracts may only be listed at values of at least $0.01 and at most $0.99. The Contract is sized with a one-dollar notional value and has a minimum price fluctuation of $0.01 to enable Members to match the size of the contracts purchased to their economic risks. The Exchange has further imposed position limits (defined as maximum loss exposure) of $25,000 USD on the Contract. 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 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

[2] As stated by the unregistered trading venue.

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.

CERTIFICATIONS PURSUANT TO SECTION 5c OF THE COMMODITY EXCHANGE ACT, 7 U.S.C. § 7a-2 AND COMMODITY FUTURES TRADING COMMISSION RULE 40.3, 17 C.F.R. § 40.3

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: Eliezer Mishory
Title: Chief Regulatory Officer
Date: 7/19/2022

Attachments:

Appendix A - Contract Terms and Conditions
Index of confidential appendices
Confidential appendices

APPENDIX A – CONTRACT TERMS AND CONDITIONS

Official Product Name: Will <party> be in control of the <chamber of Congress>?
Rulebook: CONGRESS

CONGRESS

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. For the purposes of assigning party membership: Senator Angus King of Maine and Senator Bernard Sanders of Vermont shall be treated as members of the Democratic Party. 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. For the 118th Congress, the Exchange will list contract iterations with "Democratic Party" or "Republican Party" values.

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 $25,000 per Member.

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 $1.00.

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.

INDEX OF CONFIDENTIAL APPENDICES

APPENDIX B (CONFIDENTIAL) – FURTHER CONSIDERATIONS

Note that much of the material here was included in the original formal preview of the contract that was provided to DMO on March 28, 2022, and also submitted to the Commissioners' offices after that.

Hedging and Price Basing Utility

The U.S. Constitution granted Congress extensive powers to influence the economy, including the powers to impose and collect taxes, regulate interstate and international commerce, to create money, to borrow money with American credit, and to appropriate tax revenue. Consequently, shifts in which political parties control government can portend dramatic changes in policy and personnel that could swing the fortunes of entire sectors of the economy. The resulting volatility creates substantial and well-established demand for firms to insure themselves against outcomes contrary to their interests. Unfortunately, the status quo forces these firms to choose between inefficient and indirect forms of hedging this risk and not hedging at all. This section will advance three main areas of analysis:

1. First, political control has predictable and foreseeable impacts on the macro-economy writ large and specific sectors more powerfully.
2. Second, firms already engage in behavior to hedge against such risks, indicating that the need for these hedging products exists.
3. Third, existing hedging options are inferior to being able to trade directly on political control with a CFTC-regulated product.

1. The partisan makeup of government has substantial and predictable economic impact.

The preponderance of the political science literature suggests that changes in political control have consequences. Even if reality complicates the ability to enact every aspect of a given party's agenda, a review of the literature suggests that politicians make a good faith effort to enact roughly two-thirds of their campaign agendas.[3] They not only have the ability to shape ambitious pieces of legislation that can affect the disbursement of trillions of dollars, but they possess broad regulatory authority to affect the outcomes of myriad industries. As a consequence, academic studies find that financial markets expect policy changes following elections but before policies are actually enacted. The remainder of this subsection will highlight the evidence provided by private research firms and investors, academic researchers, politically vulnerable firms themselves, and economic policymakers that political control risk is real and hedges are sought.

[3] Timothy Hill. 2016. "Trust us: Politicians keep most of their promises". *FiveThirtyEight*.

Private research firms

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.[4] 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."[5]
- **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.[6][7]
- **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."[8]
- **Bank of America** provided roadmaps for each type of partisan outcome (e.g. one party controls all of government, divided government, et cetera). There, 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.[9]
- **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

[4] Matthew Fox. 2020. "Goldman's chief economist breaks down why a Biden-led blue wave would prompt an upgrade in growth forecasts". *Business Insider.*
[5] Thomas Franck. 2020. "Goldman Sachs says Democratic sweep would unleash 'substantially' more stimulus." CNBC.
[6] Morgan Stanley. 2020. "A Revised Guide to Economic Policy Paths & Market Impacts".
[7] Morgan Stanley. 2020. "2020 US Election Preview: 5 Themes to Watch for Investors."
[8] Ksenia Galouchko. 2020. "JPMorgan Says Biden Victory Could Mark a Stock Market Shift." Bloomberg.
[9] Bérengère Sim. 2020. "Bank of America wrote a massive 92-page report on election's impact — here's what investors need to know." Financial News.

scenario.[10] They similarly projected a one percentage point lower unemployment rate and a 0.6 percentage point higher S&P 500 under a Democratic sweep.

The above research is provided to institutions, who pay for the firms' expertise on the status and future of the economy at great expense. These clients are predominantly money managers, such as hedge funds, pension funds, and other kinds of investment pools. If they did not agree that there are predictable specific economic consequences stemming from the partisan makeup of Congress, they would not pay for this research, nor would they act on it by changing their investment portfolios or hedging the risks from political control. The results of these research firms' research are often reported in the press. Both the fact that trillion-dollar investment funds pay handsomely for this information, and that the press routinely reports on this research suggest that political control has enormous economic impact.

Academic research

University-backed research confirms that the marketplace considers these risks in its operations. Researchers Erik Snowberg, Justin Wolfers, and Eric Zitzewitz used a variety of prediction markets to establish a relationship between the odds of a given party's success in Congressional midterms and financial markets and indicators.[11] 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 market participants understand that there are predictable, specific economic consequences to political control. 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.[12] 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.[13] A similar study in 2008 found that Democratic politicians polling higher than Republican ones was better for equity markets.[14]

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[10] Moody's Analytics. 2020. "The Macroeconomic Consequences: Trump vs. Biden".
[11] Erik Snowberg, Justin Wolfers and Eric Zitzewitz. "Party Influence in Congress and the Economy." 2007.
[12] Erik Snowberg, Justin Wolfers and Eric Zitzewitz. "Partisan Impact on the Economy". *Journal of Economic Perspectives.* 2004.
[13] Justin Wolfers and Eric Zitzewitz. 2016. "What do financial markets think of the 2016 election?"
[14] 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*.

Similarly, Northwestern professor Seema Jayachandran used a natural experiment to study the effects of partisan control of Congress.[15] 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. Similarly, 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%".[16] 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".[17] These findings–that changes in the expectations or outcomes of partisan political control affect financial markets–have been consistently replicated.[18][19][20][21][22][23][24][25]

Firm-level testimony

Firms themselves discuss this risk often. In Q3 2020, more than one-third of company quarterly earnings conference calls used the term 'election'.[26] On these calls, concerns were most frequently raised regarding tax reform, additional potential fiscal stimulus, and regulatory changes. In these conversations, investors frequently ask company executives what the impact of a specific partisan outcome will be (e.g. a "blue wave", divided government, et cetera) on the

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[15] Seema Jayachandran. 2006. "The Jeffords Effect". *Journal of Law and Economics*.
[16] Brian Knight. 2006. "Are policy platforms capitalized into equity prices? Evidence from the Bush/Gore 2000 Presidential Election" *Journal of Public Economics.*
[17] Andrea Mattozzi. 2005. "Can we insure against political uncertainty? Evidence from the U.S. stock market".
[18] Frederico Belo, Vito D. Gala, and Jun Li. 2013. "Government spending, political cycles, and the cross section of stock returns." *Journal of Financial Economics.*
[19] Francois Gourio, Michael Siemer, and Adrien Verdelhan. 2015. "Uncertainty and international capital flows." *Working*
paper, Federal Reserve Bank of Chicago, MIT.
[20] Kyle Handley and Nuno Limao. 2015. "Trade and investment under policy uncertainty: theory and firm evidence." *American Economic Journal: Economic Policy*
[21] Bryan Kelly, Lubos Pastor, and Pietro Veronesi. 2016. "The price of political uncertainty: Theory and evidence from the option market." *The Journal of Finance*
[22] Ralph S. J. Koijen, Tomas J. Philipson, and Harald Uhlig. 2016. "Financial health economics." *Econometrica.*
[23] Timothy Besley and Hannes Mueller. 2017. "Institutions, volatility, and investment." *Journal of the European Economic Association*.
[24] Philippe Mueller, Alireza Tahbaz-Salehi, and Andrea Vedolin. 2017. "Exchange rates and monetary policy uncertainty." *The Journal of Finance*.
[25] Michael Herron. 2000. "Estimating the Economic Impact of Political Party Competition in the 1992 British Election." *American Journal of Political Science.*
[26] John Butters. 2020. "More than one third of S&P 500 companies are discussing the election on Q3 earnings calls." Factset.

company's bottom line. Consider a few examples, beginning with Raymond W. McDaniel, CEO of Moody's Corporation, a major credit ratings agency:

> …as a starting point, we recognize that there are not going to be identical policies and priorities depending on whether there's a blue wave or whether the Republicans win, hold the Senate, win the Presidency. It's a number of combinations, none of which will produce exactly the same set of priorities and policy elements that will have to address just as our business as well.[27]

Thomas A. Fanning, CEO of Southern Company, an energy company:

> Coal depends on what happens with environmental. And that really depends a lot to a large extent on the elections going forward. If you have a blue wave, it may be that we would see perhaps tighter regulation and co-waning importance, but we'll see.[28]

Jeffrey Solomon, CEO of Cowen Inc., an investment bank:

> So, we're presuming there's a Blue Wave coming. And I would say, we'll take a step back for a second and say, regardless of what the election outcome is, there's some real underpinnings that will ignite growth. First of all, the Fed stays accommodative, regardless of who's in control. I also think there'll be a significant fiscal spending package that happens regardless of who's in control. The difference will be where the money is and the size of the money. I think from a Blue Wave standpoint, if that actually occurs, I think it's fantastic for the market to be clear. Because there will be a much bigger spending package that occurs that will more than offset any drag from tax -- from a tax increase.
>
> So, people tend to pick and choose what they want to focus on. A tax increase could impair valuations or reverse some of the gains that we saw from the last tax cuts. But effectively, we're going to go back to where we were a few years ago. That's really what we're talking about here from a tax standpoint on capital gains, at least anyway. And I think that will be more than offset by the amount of fiscal spend that's going to happen in areas like sustainability.[29]

Ken Moelis, CEO of Moelis & Company, a boutique investment bank:

> I think our M&A pace -- feels as high as it's ever been. Our backlog is as strong totally -- as it's ever been. I think it was our second earnings quarter was in late July, we said we

[27] The Motley Fool. "Moody's Corp (MCO) Q3 2020 Earnings Call Transcript."
[28] The Motley Fool. "Southern Company (SO) Q3 2020 Earnings Call Transcript."
[29] Seeking Alpha. "Cowen Inc. (COWN) CEO Jeffrey Solomon on Q3 2020 Results - Earnings Call Transcript."

> started -- we really felt it. And it may be -- that it's -- we deal with a little bit of a growth here -- middle -- a lot of what we do is in the sponsor community and possibly they responded quicker.
>
> I think the larger transactions are a little more affected by -- maybe by the election and tax policy and what happens globally.[30]

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.

As the New York Times's Conor Dougherty reported in 2016,

> Executives at Jack in the Box said uncertainty over the election could be affecting consumers' willingness to buy Jumbo Jacks and cheeseburgers. Commercial real estate brokers said the election was causing businesses to hold off on new office leases. Auto dealers said the results could determine how many people buy cars.
>
> From banking to oil to pharmaceutical companies, to real estate agents and even cruise ship operators, everyone seems to think wariness ahead of the election is affecting their business. Sometimes for the better, mostly for the worse.[31]

Policymakers

The Federal Reserve Board frequently discusses the impact changes in political expectations are having on asset markets in the context of the Board's monetary policy stance. Consider the following from the November 2020 meeting minutes:

> Yields on two-year nominal Treasury securities were little changed over the intermeeting period, while longer term yields increased modestly, on net, reportedly reflecting market participants' reassessments of the election outcome and the outlook for fiscal policy...Broad stock price indexes increased, on balance, over the intermeeting period

[30] Seeking Alpha. "Moelis & Company (MC) CEO Ken Moelis on Q3 2020 Results - Earnings Call Transcript."
[31] Conor Dougherty. 2016. "The Election's Effect on the Economy? Doughnut Sales Are Probably Safe." *The New York Times*.

> amid volatility associated with market participants' reactions to news on the U.S. election, the pandemic's trajectory, and the fiscal policy outlook...Uncertainty about additional U.S. fiscal stimulus and the outcome of the U.S. presidential election also caused some asset price volatility abroad.[32]

In the December 2016 meeting, the Board discussed the impact of the previous month's electoral outcome on a variety of assets, including Treasury yields, the equity market, overnight index swaps, and corporate bond yields.

> Surveys of market participants indicated that revised expectations for government spending and tax policy following the U.S. elections in early November were seen as the most important reasons, among several factors, for the increase in longer-term Treasury yields, the climb in equity valuations, and the rise in the dollar...Asset price movements as well as changes in the expected path for U.S. monetary policy beyond December appeared to be driven largely by expectations of more expansionary fiscal policy in the aftermath of U.S. elections...In addition, the expected federal funds rate path over the next few years implied by quotes on overnight index swap (OIS) rates steepened. Most of the steepening of the expected policy path occurred following the U.S. elections, reportedly in part reflecting investors' perception that the incoming Congress and Administration would enact significant fiscal stimulus measures...Broad U.S. equity price indexes rose over the intermeeting period, apparently boosted by investors' expectations of stronger earnings growth and improved risk sentiment, with much of the rally coming after the U.S. elections...Although gross issuance of corporate bonds slowed notably in October and November from the brisk pace in the third quarter, the decrease in corporate bond spreads after the U.S. elections suggests that the lower issuance did not reflect a tightening of financial conditions.[33]

During the December 2012 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.[34]

The Federal Reserve's October 2016 Beige Book (which is the routine survey of various corporations' estimates of their economic outlook) cites electoral risk no fewer than eight times,

[32] Minutes of the Federal Open Market Committee. November 4–5, 2020.
[33] Minutes of the Federal Open Market Committee. December 13–14, 2016.
[34] Meeting of the Federal Open Market Committee. December 11–12, 2012.

particularly in construction, auto sales, and commercial real estate.[35] This is not a new phenomenon. The Federal Reserve's Beige Book reported in 2012,

> Leasing activity is said to be down in Boston as firms say political uncertainty makes them reluctant to make leasing commitments in advance of the national election… A few builders said that they would like to hire more workers but are hesitant to do so because of uncertainty surrounding the upcoming election and the fiscal cliff… Across the board [in the manufacturing sector], contacts noted uncertainty in their outlooks due to the upcoming election.[36]

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. This provides evidence that such outcomes are a sufficient risk to be hedged.

The necessity of hedging political control itself, not merely policy outcomes

If the mechanism by which politicians affect the economy is through policy change, it might stand to reason that contracts on the outcomes of policy changes are sufficient to provide for full hedging, and there is no need for political control contracts. However, this analysis is incomplete. There are two core reasons why political control contracts add hedging utility above and beyond specific policy contracts.

First is the uncertainty surrounding specific policy outcomes. For example, immediately after the Republican party assumed control of government in 2016, there was widespread sentiment that trade tensions with China would increase. However, little was known about the form that trade tensions with China would take, such as which restrictions might be enacted (tariffs, World Trade Organization lawsuits, sanctions, withdrawal from global free trade agreements, and many more), when those would happen, in what context, and so on. Nonetheless, without any specific policy, market participants were confident that the change in political control implied an increase in trade tensions, prompting recommendations by financial institutions to sell Asian currency, Asian equities, and the Mexican peso.[37] Enough was known to change asset prices and investor behavior based on public information. However, because the policy particulars were unknown, there was practically no way for a DCM to provide a market for its Members that would hedge such a risk in advance of policy enactment. Because of its obligations to be specific about resolution mechanisms for manipulation and anti-fraud purposes, a DCM cannot, and should not, propose vague markets like, "Will the U.S. start a 'trade war' somewhere?" or "Will trade tensions increase?" However, a political control event contract would capture this event risk. In this regard, it is precisely because the *particular* economic outcomes of political control are

[35] Summary of Commentary on Current Economic Conditions by Federal Reserve Districts. October 2016.
[36] Summary of Commentary on Current Economic Conditions by Federal Reserve Districts. September 2012.
[37] Goldman Sachs. "Beyond 2020: Post-election policies."

sometimes unclear that the market needs such contracts. Firms need to hedge against parties' policy stances, e.g. hostile to trade, pro-tax increases, supportive of stringent environmental regulation, etc., *because* the precise implementation of those stances is not identifiable ahead of time.

The second is the breadth of changes political control of government can portend. The impact of congress is much broader and reaches much further than legislation. Consider a firm in the energy sector which is exposed to political risk. It is concerned that a new Congress will increase subsidies for their competitors and there will be new regulations and new procedures imposed on the business. These risks are affected by potential legislation from congress, and also from non-legislative elements like budgets for regulators and signaling to regulatory agencies. There are many subtle and nuanced ways that political control impacts this that it might not even be possible to list contracts on them all, and certainly not feasible. Even events that could be defined might not have widespread enough interest to create a liquid market useful for hedgers to price-take, and many events will not be defined to even have a market on them. Because political control creates so many changes across government, it is easier for firms and exchanges to hedge using the catalyst of policy change itself (the change in political control) rather than all of the many particular policy and personnel outcomes that could come.

Market participants could use political control contracts to hedge the direct and linear change to the risks the political system poses to them, which is similar to how market participants use other, existing contracts to hedge such as hurricane contracts and economic indicator contracts.

Political control contracts could be used by all segments of market participants–retail, small businesses, and enterprise–to hedge their risk exposure to political control.[38] Various policy outcomes directly result in economic consequences to which market participants may be vulnerable. Political candidates consistently and vocally signal their competing policy intentions. While the policy might not end up being implemented, the likelihood of such a policy being implemented is greater if the party in favor of that policy has political control, and less if the party in favor of that policy does not have political control. As such, there is a connection between political control and the market participant's exposure to unfavorable outcomes, and that risk can be hedged like any other. A market participant negatively exposed to a party's platform would hedge that risk by buying political control contracts that the party in favor of that policy would have political control. Conversely, a market participant who stands to gain from a party's platform would hedge the risk that a policy is not implemented by buying political control contracts that the party in favor of that policy would not have political control.

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[38] Kalshi currently has a $25,000 position limit on all of its contracts. This position limit might limit the efficacy of the contract for the largest enterprises, although the market is open to all eligible participants. This position limit is 1/10th the size of Nadex's position limit on its presidential election contracts. It is sufficient for the needs of many individual participants and some small businesses, and can be used by all market participants to hedge at least a portion of risk.

Even though there is no guarantee or certainty that a party's platform will or will not be implemented to completion regardless of control, the likelihood of the party's platform being implemented will change based on whether the party has political control, and therefore the risk associated with that platform will change too. That change in risk is what political control contracts hedge. Put another way, an outcome does not have to be certain in order to be hedged.

Hedging political control is like hedging any other risk exposure to events: firms and individuals hedge likelihoods, not absolutes. Market participants seeking to hedge risks associated with rising inflation do not know whether the price increases will be concentrated in the exact sector to which they are most exposed or how inflation will actually affect their bottom lines. Yet, because an increase in the broad measure of inflation substantially increases the likelihood that they will be exposed to impacts from inflation, firms hedge accordingly. Individuals in a recession do not know with certainty whether they will lose their job (indeed, most people retain their jobs during recessions). Yet, because a recession substantially increases the probability of losing their job, that change to the risk is hedged. There is a direct, linear connection between the underlying event and a financial risk, regardless of potential uncertainty through intermediate channels.

Consider a contract on whether a hurricane will occur. There is no certainty regarding the impact that a storm will inflict, such as the amount of damage, the type of damage, whether there will be flooding, electrical outages, and so on. There is no guarantee or certainty that a hurricane will cause any damage to any market participant, and there is no guarantee or certainty that a hurricane will make landfall. Yet, market participants hedge the *risk* – the increased likelihood – that they will suffer economic harm because of the hurricane. Hurricane contracts are a staple in OTC markets and on CFTC regulated exchanges like Cantor Fitzgerald and the Chicago Mercantile Exchange because market participants hedge the risk of a hurricane, not just the certainty.[39][40][41]

The same is true for a political control contract. Political control changes the likelihood of the economic risks market participants are exposed to. Those changes can be hedged, just like a market participant using a hurricane contract hedges changes to her economic risks from the weather or one using economic indicator contracts hedges the change in her risks from changes

[39] CX Markets. https://weather.cxmarkets.com/

[40] CME Hurricane Index Futures and Options. https://www.cmegroup.com/trading/weather/files/WT106_NEWHurricaneFC.pdf

[41] *See also MANAGING CLIMATE RISK IN THE U.S. FINANCIAL SYSTEM*, Report of the Climate-Related Market Risk Subcommittee, Market Risk Advisory Committee of the U.S. Commodity Futures Trading Commission (noting, in Chapter 3 that while the specific impacts of climate change are far from known, nonetheless, firms hedge climate change risk. And also discussing, in Chapter 6, "scenario analysis" and "scenario planning", which it describes as " less about forecasting the most probable outcomes than it is a "what-if" analysis of different potential projections of the future," and stating that climate-related scenario analysis are being used "by banks and other financial institutions to assess individual investments and overall portfolios.").

to the indicator. Accordingly, if the economic consequences of changes in macroeconomic conditions or weather conditions can be hedged with such contracts, then hedging should also be allowed to mitigate the risk of direct economic consequences from changes in macro-political conditions (i.e., changes to political control) via a political control contract.

Here are several examples of how this would work:

- A firm supplies parts to hydrogen fuel cell companies. One party's platform includes new policies that will disfavor the firm's main clientele. These policies are broad and could end up being reduced subsidies, relaxed requirements to be carbon neutral, the removal of tax breaks, subsidies going to competitors in traditional fossil fuel industries, and others. Any one of these would impact the supply firm's bottom line because there would be less demand for its parts. The likelihood of one of these policies being implemented is greatest if the party proposing these policies is in control, is less if neither party is in control, and is least if the other party, the one who does not have these policies in its platform, is in control. The firm can use political control contracts to hedge the greater risk, whatever its risk management strategy is.
- A firm is a qualified opportunity zone fund under I.R.C. section 1400Z-2. The fund is exposed to changes in the tax laws that relate to it. The likelihood (not the certainty) of an unfavorable tax law being passed is greater if a particular party has political control, less if no party has political control, and even less if another party has political control. As noted above, the market factors political control into investment decisions. Potential investors in the fund might be reluctant to invest because of the risk level of an unfavorable tax policy being implemented. The firm can use the political control contract to hedge that risk according to its risk management strategy to address investors' concerns.
- A small online business imports its inputs from China. The business is exposed to the risk of increased trade tensions. One party's platform includes policies that increase the likelihood of trade tensions. Trade tensions could result in new tariffs (possibly on their inputs, possibly not), changes to existing trade agreements, or threats of such changes that cause market uncertainty, and could result in higher costs. The likelihood of one of these policies being implemented is greatest if the party proposing these policies is in control, is less if neither party is in control, and is least if the other party, the one who does not have these policies in its platform, is in control. The firm can use political control contracts to hedge the greater risk, whatever its risk management strategy is.
- A household is dependent on a new suite of policies enacted in order to maintain their current lifestyle as they raise a new set of children. This includes a newly legislated Child Tax Credit, paid parental leave, and regular stimulus payments. However, these policies are sunsetted, and should a different party take over, they will not be extended. The likelihood of these policies being extended is greatest if the party proposing these policies is in control, is less if neither party is in control, and is least if the other party, the one

who does not have these policies in its platform, is in control. This household could use a political control contract to hedge the risk that a new party enters government that will be less friendly to a big-government, subsidy-heavy, welfare-state aligned policy agenda.

- An individual is returning to school; however, they are financially constrained. They would be significantly less burdened if a party came into government that has credibly committed to a moratorium on student loan payments, forgiving student debt, making community college free for individuals under a certain income threshold, and expanding the suite of persons eligible for federal grants and subsidized loans. In addition, family members tell them they would be more likely to financially support their return to school under such circumstances. The likelihood of one of these policies being implemented is greatest if the party proposing these policies is in control, is less if neither party is in control, and is least if the other party, the one who does not have these policies in its platform, is in control. Thus, this individual can mitigate the risk associated with tuition and investment in schooling by using a contract on partisan political outcomes to hedge the risk such a party does not enter office.

There is also an economy that is built around Congress and political control. Participants who have economic exposure to the government relations field can use the contract to hedge. The value government relations professionals deliver to their clients is largely dependent on their connections and relationships – if the party the government relations professional is affiliated with does not control Congress, the value to clients is reduced. After all, having relationships with those who control key committees can be more useful than being close with the minority party.[42] There is a direct linear connection between the party in control of Congress and the likelihood of a decrease in potential value to clients from individual government relations professionals. According to an analysis by OpenSecrets.org based on data from the Senate Office of Public Records, in 2020-2021, over $7 billion in industry spending was reported.[43][44] That substantial amount of money is just one facet of the broader government relations economy. Many government relations professionals work for firms that also employ researchers, planners, managers, secretaries, and others. These firms rent offices, hire cleaning crews, and buy insurance policies. They also go to lunch and dinner, travel, and host events that are economically significant to the local hospitality and entertainment industries. All of the individuals and firms that are tied to government relations have economic exposure to the success of government relations firms which have exposure to which party has control over Congress.

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[42] One well known relations firm brags in their marketing materials "Our access to decision makers on Capitol Hill allows us to develop and execute strategic advocacy roadmaps that pair priority needs with concrete methods to achieve them." Advocacy - FS Vector. Several firms, accordingly, are careful to bill themselves as bi-partisan. For example, one firm displays the following quote on their website: No policy battle is too challenging for this bipartisan firm, which is packed with Republican and Democratic power players. Capitol Counsel LLC. This further indicates that the success of government relations firms is affected by political control.

[43] Data Summary • OpenSecrets

[44] Total spending U.S. 2021 | Statista

In-house government relations professionals, and the firms that employ them, can also use the contract to hedge their risks. Take, for example, a pharmaceutical company that is looking to expand its government relations team. It has one opening that it intends to fill shortly after the elections in November. The company identifies two equally qualified candidates who both have extensive Hill experience, one that is credentialed with one political party and the second with the other. The company might base its hiring decision on member affiliations on the candidates' resumes, assuming that the candidate that is better connected will be more effective. Thus, the two candidates both have significant exposure to political control and can use the contract to hedge their risk exposures. Similarly, a consulting firm that provides government relations services and has strong connections to party Y determines that party Y will have political control over Congress in an upcoming election. Because of their connections to party Y, the firm expects to see an increase in demand for its services. In order to stay ahead of demand, the firm plans to hire two new IT professionals and a new secretary. The firm might identify that it is at risk of party Y not having political control, in which case the anticipated increase in demand is less likely to materialize. The firm can hedge that risk by utilizing the contract. The applicants to the firm for those jobs can also hedge the risk that party Y does not have political control, and the firm might pull the offers or institute layoffs.

Political control in Congress can have an impact on non-partisan issues as well, such as the design and architecture of how legislation is implemented, and the particular priorities of various committees that impact Congress's business as a whole. These can have significant economic impacts on market participants that can be hedged by using the contract. To illustrate, consider a firm that provides advocacy, government relations, or advisory services. The firm has expertise in a specific field or issue. They can expect to see an increase in demand for its services if there is an increase in government focus on that particular issue. Political parties often differ on key priorities outside of partisan issues, and market participants, through their own thorough research, may determine that there is a likelihood of an increase or decrease in activity based on which political party is in control. Additionally, the impact of political control is not limited to just the potential partisan priorities and political viewpoints of that party. Certain members of a particular party may champion different causes, even if those causes are not necessarily partisan in nature. A given member might also have a familiarity or connection to a particular agency or style of regulating. These differences between members can have significant impacts on industries. Whether that member is in position to advance her agenda may depend on her committee assignment and placement within that committee, for example, a given member might either be the chairwoman of a committee or its ranking member, depending on whether her party has control over the chamber. As chairwoman, she will be in position to shape policy in a manner that is very different than she could as a ranking member. Those differences aren't necessarily partisan in nature, and can range from the nature of the regulatory regime imposed on a nascent industry to which regulatory agency is given jurisdiction over the industry. Market participants,

through their own thorough research, may determine that there is a greater likelihood of a certain issue coming to the fore if a certain member is in a position of power, which depends on which party has political control.

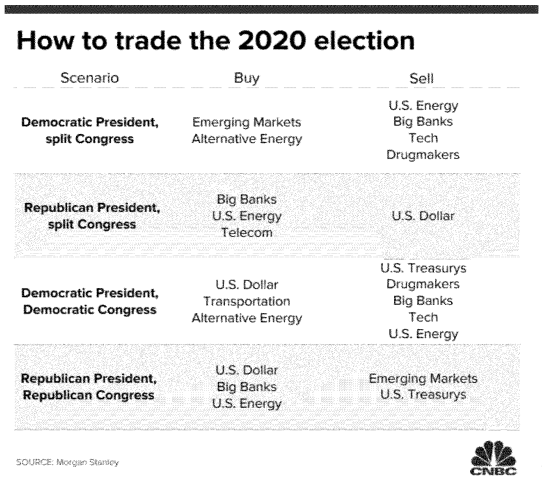
To give a hypothetical example of how this would work, consider if there was an emerging issue and there was discussion whether to assign jurisdiction over the issue to two hypothetical agencies, one called the QFPB and the other the FTQ. Both agencies are regulated by the same committee of jurisdiction in the Senate. The chair of the committee has close ties to the QFPB and the ranking member's chief of staff worked at FTQ for many years. A policy advocate who used to be the Deputy Director of the FTQ might determine, through her own research, that if the Ranking Member becomes the Chair, it is likely that the issue will be legislated into FTQ's jurisdiction. In addition to the foundational issue of jurisdiction, the ensuing legislation will have many and varied policy points, each one of which will be impactful and provide the policy advocate with work to do advocating on behalf of her clients. That policy advocate might have significant upside if the ranking member becomes the Chair of the committee. Conversely, if the current Chair retains her seat, the policy advocate determines that there is an increased likelihood that the issue is given to the jurisdiction of the QFPB. If that happens, the policy advocate may lose out on that upside, and may even become less relevant. Of course, the policy advocate understands that nothing is guaranteed. These are risks and likelihoods. There is a greater likelihood that she will see increased demand for her services if the ranking member ascends to the chair, and a greater likelihood that she will not if the current chair remains. These likelihoods are risk exposure. The policy advocate can hedge her risk exposure using the contract.

Similarly, demand for think tank services varies based on political control. While some political think tanks, particularly those focused on opposition research and government accountability, thrive when the party they are associated with loses, this is not the case for the most powerful among them. Think tanks like the Center for American Progress and the Heritage Foundation, for instance, are well-known for their associations to Democratic Party and the Republican Party politics respectively. Many staffers at these organizations use their credentials and connections from their time in the think tank space as a launchpad into getting more powerful government roles. Moreover, the appeal of working for these organizations depends on their influence, and the writings of the Heritage Foundation are far more influential when the Republicans are in power than when the Democrats are. As a result, it may be easier to raise money from donors or recruit high-end talent when the think tank can faithfully say "our ideas are constantly influencing important legislation on the issues that matter most to you". As a result, independent of the particular policy outcomes that a Congress may enact, the identity of the party that is in control has a predictable financial impact on thousands of individuals in these industries.

2. **Firms already hedge against political control.**

The first section established that despite the uncertainty inherent in the political process, political control has foreseeable impacts on the macroeconomy and specific sectors of the economy. If firms actually believe that these risks need hedging, then they would want to *de facto* insure themselves against the possibility of negative policy change even without CFTC-regulated products that do so. We find that this is the case. Firms and individuals do seek out hedging products to mitigate their own financial exposure to partisan political outcomes.

As noted earlier, private research firms provide analysis on political outcomes for their clients. However, this guidance does not merely discuss the economic impact of certain political outcomes–it also discusses how clients can hedge and avoid the risks associated with a given outcome. In 2020, Goldman Sachs provided a report on how to trade on a clear election outcome; Jefferies created a list of European stocks well-positioned for either a Trump or Biden victory; and Stifel broke down the impacts of many different scenarios, such as "blue sweep" or "Biden stalemate" on major assets and sectors.[45] Consider this chart from Morgan Stanley, as reported by CNBC:



How to trade the 2020 election

Scenario	Buy	Sell
Democratic President, split Congress	Emerging Markets Alternative Energy	U.S. Energy Big Banks Tech Drugmakers
Republican President, split Congress	Big Banks U.S. Energy Telecom	U.S. Dollar
Democratic President, Democratic Congress	U.S. Dollar Transportation Alternative Energy	U.S. Treasurys Drugmakers Big Banks Tech U.S. Energy
Republican President, Republican Congress	U.S. Dollar Big Banks U.S. Energy	Emerging Markets U.S. Treasurys

SOURCE: Morgan Stanley

CNBC

[46]

Or consider this sector-specific example from Stifel, as reported by the Financial Times:

> A Blue Wave would suggest a unified federal government more amenable to cannabis reform. We believe a Blue Wave is likely to include numerous headlines promoting the prospect of wholesale federal change, including the descheduling of cannabis (as included in the MORE Act, which was scheduled for a vote in the U.S. House of Representatives) by removing cannabis from the purview of the Controlled Substances Act. Given the heavy retail exposure and likely promotion of the potential for federal

[45] Jamie Powell. 2020. "How to trade the US election." *Financial Times*.
[46] Thomas Franck. 2020. "Morgan Stanley has a simple guide for investors on how to trade the 2020 election." *CNBC*.

> change, we believe a Blue Wave would bring broad undifferentiated favor to cannabis equities.

This research and analysis is provided by investment banks to institutional investors, such as pension funds, sovereign wealth funds, hedge funds, and even other investment banks. Some of these actors manage trillions of dollars in assets for clients who bear large exposure to predictable political control risk. From the *Financial Times*:

> "There absolutely has been a big uptick in election hedging activity," said Pravit Chintawongvanich at Macro Risk Advisors. "I think that is what is driving volatility. We have seen the Vix rising while the market is relatively quiet. Investors are very specifically targeting the election with expiry a few days or a week after it.[47]

In addition to providing guidance through their research, a core practice of investment banks is to create specific products to manage risks for clients. In this context, this could take the form of over-the-counter products on political outcomes or a specific portfolio of complex financial assets narrowly tailored to target political control risk. For example, suppose a hedge fund with exposure to for-profit higher education firms wants to hedge against the risk that President Biden will be re-elected, which may enhance the prospects of a regulatory crackdown. It may then seek to purchase other assets that would likely rise if Biden wins, such as green energy stocks or short-sales on particular currencies.

The existence of costly information on how to hedge political control risk, as well as the existence of products targeting it, thus suggests the need for a CFTC-regulated product to mitigate the risk.

3. **Existing hedging mechanisms are exclusive and inefficient.**

Existing mechanisms for hedging political control are inferior to being able to trade directly on the event. Assembling a bespoke portfolio of equities to reduce electoral exposure requires paying substantial fees to investment banks and other dealers to assemble the portfolios. This is unfair and gives an advantage to large, established financial firms over more specialized ones. In addition, it is unavailable to the retail investor and small businesses. This creates an imbalance between the hedging capabilities of retail and institutions, even though retail and small businesses are subject to identical risks. Being able to trade directly would have fewer frictions and fewer costs.

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[47] Joe Rennison. 2016. "Hedging activity rises as odds on Donald Trump win fall." *Financial Times.* https://www.ft.com/content/ea338340-a3ce-11e6-8b69-02899e8bd9d1

As a result of the high cost of those products, fewer firms choose to try and hedge political risk and instead have to hedge risk themselves. These decisions are opaque, and the public cannot benefit from price discovery since the values of these portfolios are not publicly available. These hedges are also not able to perfectly isolate political control risk, and end up forcing firms to take on more risk than they would like. This is because the value of these assets (like foreign currencies and politically-sensitive equities) is determined by factors unrelated to the risk, even if political risk is incorporated into its value. Although foreign currencies, major equities, Treasuries, and corporate bonds all are impacted by political control, their values are mostly determined by other fundamentals.

The status quo incentivizes firms to turn to high-cost, exclusive investment banks to create imperfect political control hedge baskets or risk the tides of the market. Yet, the demand for such flawed tools underscores how great the demand for electoral hedging is. Being able to trade directly would thus allow these firms to achieve their same goals but at lower costs, greater transparency and greater certainty.

2. Price Basing Utility

As noted above, political control has predictable economic impact. This impact is felt in many sectors of the economy, and affects individuals, small businesses, and large enterprises. Many of the affected firms themselves support a large ecosystem of economies and the economic risks faced by participants in these economies have direct exposure to the outcome of political control. Accordingly, predictive data on the outcome of political control is very valuable as a tool in economic decision making. For example, if a firm that believes that if a certain party is in control of Congress, its business will benefit and necessitate the hiring of ten new employees and retaining three new service providers would be able to use the data from the contract to determine the probability that the party is in control. That data could be used by the firm to determine how many new employees to hire, if any at all. That data could be used by the firm to determine whether to enter into the new service agreements. It is no wonder that financial news sites such as CNBC have dedicated election channels and regularly feature polls during election cycles. The price embedded in the Contract impacts the pricing of commercial transactions involving physical commodities, financial assets and services. The discussion above regarding hedging policy outcomes makes this point, and in the interests of avoiding duplication it will not be repeated here.

Additionally, there are other contacts, such as MIAX's corporate tax futures, that regard corporate tax rates. Naturally, the probability and potential intensity of tax increases changes with political control, and thus the Contract could be used to price those contracts. Of course, Kalshi and other DCMs have many contracts (such as those on economic indicators, taxes, student debt forgiveness, and more) that are in part dependent on political control.

Moreover, political control can be factored into the price of many physical commodities. For example, a study by economists Erik Snowberg, Justin Wolfers, and Eric Zitzewitz studied the 2004 election and concluded that changes in the probability of Republican political control had statistically significant and strong effects on the price of a barrel of oil (among other financial assets, such as the US dollar).[48]

Reuters reported in November 2020 that tighter-than-expected election results were raising S&P futures prices on the expectation that narrow Congressional majorities would limit Congressional Democrats' regulatory ambitions.[49] *MarketWatch* reported that the election was roiling oil futures markets due to the candidates' differing views on energy policy and environmental regulation.[50] Agricultural economists even reported that wheat futures rebounded in November 2020 on expectations of changes in US trade policy stemming from President Trump's defeat.[51]

Disrupting Misinformation

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. These incentives tend to come from three sources: first, pundits may want to hype up a preferred candidate's chances in order to flatter the sensibilities of their audience. Second, pundits may want to directly contradict a so-called "mainstream" line about a candidate winning in order to gin up controversy and draw more clicks or viewership. As a result, they may claim an underdog is actually the true favorite and, to further court controversy and viewership, claim that evidence to the contrary is a function of fraud and deception. Third, even when pundits attempt to be honest, viewers themselves may seek out information that confirms their own biases, thus rewarding a subset of biased commentators with greater advertising revenue from the increased viewership or readership. In fact, we have empirical evidence of the poor performance of media figures in the science of prediction. For example, University of Pennsylvania professor Philip Tetlock evaluated the statements made by pundits and found that 15 percent of statements claimed to be "impossible" did indeed occur and 27 percent of statements claimed to be a "sure thing" did not.[52]

By providing an instant check against pundits, a market-based price created by the Contract 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 candidate X is a

[48] Erik Snowberg, Justin Wolfers and Eric Zitzewitz. "Partisan Impact on the Economy". Journal of Economic Perspectives. 2004.
[49] Noel Randewich. 2020. "S&P 500 futures rise as U.S. election suggests less regulatory risk." *Reuters*.
[50] Myra P. Saefong. 2020. "Here's how the U.S. presidential election could shake up the oil market." *Marketwatch*.
[51] Matthew Weaver. 2020. "Congressional elections could impact commodity prices most, expert says." *Capital Press*.
[52] Philip Tetlock. "Expert Political Judgment". 2005.

"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.[53][54][55][56] 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 futures are better at predicting the weather than meteorologists.[57][58] Markets trading on the reproducibility of scientific research are better at discovering which papers will reproduce than experts, who do no better than chance.[59] Most importantly, research studying IEM and PredictIt have confirmed that markets provide more accurate information than traditional forecasting methods.[60][61]

By creating a visible, well-trusted benchmark against which to evaluate a pundit's predictive power, Tetlock writes, "prudent consumers should become suspicious" when they confront a public record of poor performance relative to the market. In Tetlock's 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?"

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[53] Justin Wolfers and Eric Zitzewitz. 2004. "Prediction Markets." *Journal of Economic Perspectives*.
[54] 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,1 Thomas C. Schelling,1 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*.
[55] 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.
[56] Georgios Tziralis and Ilias P. Tatsiopoulos. 2007. "Prediction Markets: An Extended Literature Review." *The Journal of Prediction Markets*.
[57] Richard Roll. 1984. "Orange Juice and Weather." *The American Economic Review*.
[58] Matthias Ritter. 2012. "Can the market forecast the weather better than meteorologists?" *Economic Risk*.
[59] 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*.
[60] 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.*
[61] Joyce Berg, Forrest D. Nelson, and Thomas A. Reitz. 2006. "Prediction market accuracy in the long run." *International Journal of Forecasting*.

APPENDIX B.1 (CONFIDENTIAL) - EXTENDED CASE STUDIES ON THE HEDGING, PRICE BASING UTILITIES OF THE CONTRACT AND POLITICAL EXPECTATIONS

Below are several case studies involving different sectors of the economy and regulation that demonstrate the hedging and price basing utilities of the contract; as well as the link between political expectations and outcomes.

Case Study from 2020: Energy Policy

Presidential administrations and Congress have large discretion over - and opportunity to impact with great intensity - the domestic energy landscape. They can initiate regulatory changes with implications for permitting, emissions standards and other environmental standards that could impact the profitability of different firms. In 2020, several of these issues were at stake: as delineated by the Atlantic Council's David Goldwyn and Andrea Clabough, the differences between a Democratic and Republican could hardly have been more stark.[62] More Republican control, for example, would likely have ushered in greater drilling opportunities in the Arctic and Atlantic coastlines, faster review processes under the Clean Water Act and National Environmental Policy Acts and relaxed emissions standards for fossil fuel-fired power plants. If the hypothesis that changes in the partisan makeup of Congress create *predictable and foreseeable economic outcomes* is correct, then we should expect to see these policy differences manifested in the equity prices of different energy companies. When positive news about Republicans' chances emerge, the stock prices of fossil fuel companies would likely rise. When positive news about the Democrats' chances surface, renewable energy stocks would rally.

Indeed, this prediction is borne out by reality. As reported by CNBC, "expectations of an infusion of investment in alternative energy should Democratic challenger Joe Biden win the presidency have sent the TAN solar ETF soaring this year, up 123%."[63] Bloomberg reported that on the days following election night, when early returns seemed to make the prospect of a Democratic Senate slim, renewable stocks "slumped" while oil and gas stocks like ConocoPhilips "rallied".[64] One major solar provider FirstSolar's stock was so tightly linked to election returns that it fell immediately following election day (when Trump's re-election seemed likely) before spiking 11% when the election was finally called for Biden.[65] It's worth flagging that these benefits do not merely accrue to large corporations. From small-scale solar panel

[62] David Goldwyn and Andrea Clabough. 2020. "Election 2020: What's at Stake for Energy?" *Atlantic Council.*
[63] Keris Lahiff. 2020. "Biden's prospects send solar stocks soaring, but trader sees trouble ahead." *CNBC.*
[64] Will Wade, Brian Eckhouse and Gerson Freitas Jr. 2020. "Investors Sour on Green Wave as Democrats' Hope for Senate Fades." *Bloomberg.*
[65] Matthew Farmer. 2020. "How have US energy stock prices reacted to Biden's US election win?" *Power Technology*.

installers, to wind turbine technicians, to coal miners, the value of an electoral hedge is valuable regardless of one's financial resources.

Tax, Investment Decision-Making & the 2016 Election

The complete Republican victory in the 2016 Presidential and Congressional elections resulted in the swift passage of a tax reform bill that reduced corporate taxes, modified major tax deductions (such as the child tax credit, mortgage interest rate deduction, and the state and local tax deduction), and enabled accelerated expensing for certain short-lived investments such as machinery.

Consider a shipping company like UPS or FedEx that is trying to decide whether or not to invest in a major new distribution hub. These centers–which involve hundreds of thousands of square feet of floor space, vast technology for package processing, and complex logistics involving trucks and airplanes–can cost in excess of $1 billion to construct, with smaller centers costing $10 million to $50 million.[6667] These investment decisions must be made in advance but are highly sensitive to changes in the tax code. If the 2017 tax cut bill never becomes law, for a $100 million investment in machinery that lasts 10 years, one can only deduct $10 million in taxes (in contrast, the company can deduct the full $100 million in year one under the full expensing provision). The tax bill for that company then decreases by a full $32.9 million in year one through the lowered headline rate and the new depreciation rules. While these gains would be smaller in future years, due to the time value of money, the combination of the bonus depreciation rules and the lower headline rate could be the difference between making the decision to invest and deciding not to. These benefits are not hypothetical. The Tax Foundation's review of the economic literature estimates that full expensing boosts investment by roughly 2.5%.[68] Since major investments must be planned in advance, knowing the probability that a party will enter power plays a \role in corporate decision-making. The decision whether or not to engage in certain commercial transactions (willingness to accept a good at certain prices) can thus depend on the price of a political control contract.

The benefits accrue to retail investors such as individuals and small businesses. If someone is trying to decide whether or not to take on a mortgage or move to a new state, knowing whether the mortgage interest rate deduction or the state and local tax deduction will be limited becomes relevant. A couple deciding whether their financial situation is stable enough to start a family may care about the generosity of the child tax credit. A young worker trying to decide whether to start their own business might want to know whether their headline tax rates will be lower in the future.

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[66] Jacob Steimer. 2020. "Follow FedEx's money." *Memphis Business Journal.*
[67] Greg Clinton. "What does it cost to build a FedEx distribution center?" *Buildzoom*.
[68] Anna Tyger. 2019. "New Evidence on the Benefits of Full Expensing." *Tax Foundation*.

Health Insurance Decision-Making & the 2016 Election

Much like the campaign four years prior, Republicans in 2016 repeatedly promised to repeal the Affordable Care Act. Ultimately, they removed some components–the individual mandate, the Cadillac tax, and the medical device tax–while keeping components like the individual market subsidies.

Studies found that policy uncertainty had negative effects on the health insurance marketplace. According to one study from the Urban Institute, "uncertainty over how Congress will act and when insurers will obtain information about the rules under which they must operate will lead many to reassess their participation in these markets and others to significantly increase premiums."[69] After all, few entrants wish to begin offerings in an individual marketplace that may soon be eliminated, or for whom much of the rationale for entrance (everyone is forced to buy insurance, the insurance is heavily subsidized by the public) might soon be yanked away. The study emphasizes that health insurance companies were confident that they could handle a repeal, reform or maintenance of the status quo. What deterred them was not the change–it was *uncertainty about change.* When one doesn't know who is going to win an election, it is difficult to make long-term business plans for the future.

Therein lies the price-basing utility for political control contracts. If a health insurance company is deciding whether to enter a marketplace or deciding what rates to set, they need to know the policy environment they will be facing. But that policy environment depends directly on who controls Congress and the Presidency. As a result, the information embedded in the price of a political control contract has a direct bearing on services.

The price-basing utility is also strong for retail investors such as individuals and small businesses. One fear individuals have when deciding to start their own business is the loss of health insurance.[70] Knowing whether or not one's individual insurance subsidies will persist two years from now can be important to making the best decision for ones' family.

Energy Sector Decision-Making & the 2020 Election

Many energy investments take years to come into fruition. Utility-scale solar plants take around 5 years to build, with nearly all of the time related to permitting, siting and environmental review.[71] Nuclear plants can often take even longer.[72] Building major transmission lines can take

[69] Sabrina Corlette, Kevin Lucia, Justin Giovannelli and Dania Palanker. 2017. "Uncertain Future for Affordable Care Act Leads Insurers to Rethink Participation, Prices." *Urban Institute*.
[70] Robert W. Fairlie, Kanika Kapur, Susan M. Gates. 2011. "Does Employer-Based Health Insurance Discourage Entrepreneurship and New Business Creation?" *Rand Corporation*.
[71] "Siting, Permitting & Land Use for Utility-Scale Solar." *Solar Energy Industries Association*.
[72] Pedro Carajilescov and João M. L. Moreira. 2011. "Construction Time of PWRs." *International Nuclear Atlantic Conference*.

decades as disputes over land wind their way through the court system.[73] Energy investments must thus be made well in advance of going to market, and companies must secure financing and make financial projections with significant policy uncertainty. As shown above, elections have meaningful effects on the profitability of energy investments, as they can result in different levels of subsidies, environmental scrutiny, deductibility eligibility, and beyond.

Policy uncertainty is a deterrent in renewable energy investment. As Professor Kelly Burns writes, "there is a clear inverse relationship between trends in REI [renewable energy investment] and EPU [economic policy uncertainty]...when the level of EPU rises (falls), the level of REI falls (rises). This is evidence that EPU influences REI in the USA."[74] Studies repeatedly show that uncertainty over whether the wind production tax credit will be extended, for instance, is a deterrent to financing new utility-scale wind farms.[7576] The same dynamic exists in fossil fuel generation. An S&P Global report cites many coal executives, who said that they could only make investments in new coal generation if the Republicans won a trifecta in 2020.[77] They reported,

> The lack of focus on coal in the 2020 campaign reflects the "highly unlikely" prospects of a revival in coal-fired generation, which would only occur if the federal government subsidized coal production, said Ethan Zindler, head of Americas for BloombergNEF. Such an effort would require unified Republican Party control of the U.S. Congress and the White House come January 2021, the chances of which are "next to none" based on pre-Election Day polling.… Building a coal-fired power plant comes with regulatory and policy risks managed over multiyear permitting and construction timelines for plants where it may take decades to recoup the investment.

ADDITIONAL CASE STUDIES DEMONSTRATING THE LINK BETWEEN POLITICAL CONTROL EXPECTATIONS AND ECONOMIC OUTCOMES

Case Study from 2010: Budget & Debt Ceiling Showdowns

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[73] Associated Press. 2022. "Hydro-Quebec halts work on its part of hydropower corridor." *Spectrum News.*
[74] Kelly Burns. 2019. "On the Relationship between Policy Uncertainty and Investment in Renewable Energy." *International Association for Energy Economics*.
[75] Barradale, Jones Merrill. 2010. "Impact of public policy uncertainty on renewable energy investment: Wind power and the production tax credit." *Energy Policy*.
[76] Derya Eryilmaz and Frances R. Homans. 2016. "How does uncertainty in renewable energy policy affect decisions to invest in wind energy?" *Electricity Journal.*
[77] Jacob Holzman and Taylor Kuykendall. 2020. "Coal sees diminished role in US presidential race with odds slim for new plants." *S&P Global*.

In President Barack Obama's words, the Democrats took a "shellacking" in 2010, as Republicans flipped 60 seats in the House and six seats in the Senate.[7879] As a result, instead of unified Democratic control (as existed from 2009-10), Democrats needed Republican approval in the House to pass any legislation. In an era of heightened polarization, this "split Congress" ground routine government operations to a halt.

The tensions reached a head in summer 2011, a scant few months after the new Congress started. Republicans and Democrats failed to reach an agreement to raise the debt ceiling–a heretofore uncontroversial practice–thrusting the country into economic turmoil. IMF economist Filippo Gorri estimated that the "disagreement between Republicans and Democrats over the rise in the US debt ceiling" raised US government credit default swap costs by 46 basis points and bank financing costs by 18 basis points.[80] A U.S. Department of the Treasury retrospective determined that the 2011 debt ceiling shutdown increased volatility, widened credit spreads and slowed job growth for months after the crisis was ultimately resolved, as consumer confidence fell 22 percent.[81] As they wrote,

> The United States has never defaulted on its obligations, and the U. S. dollar and Treasury securities are at the center of the international financial system. A default would be unprecedented and has the potential to be catastrophic: credit markets could freeze, the value of the dollar could plummet, U.S. interest rates could skyrocket, the negative spillovers could reverberate around the world, and there might be a financial crisis and recession that could echo the events of 2008 or worse. Political brinkmanship that engenders even the prospect of a default can be disruptive to financial markets and American businesses and families.[82]

They wrote further,

> The S&P 500 index of equity prices fell about 17 percent in the period surrounding the 2011 debt limit debate and did not recover to its average over the first half of the year until into 2012. Roughly half of US households own stocks either directly or indirectly through mutual funds or 401(k) accounts, so this fall in equity prices reduced household wealth across a wide swath of the economy. Between the second and third quarter of 2011, household wealth fell $2.4 trillion. A decline in household wealth tends, all else equal, to lead to a decline in consumption spending, and consumer spending accounts for roughly 70 percent of GDP. Moreover, because a good deal of retirement savings is

[78] Liz Halloran. 2010. "Obama Humbled By Election 'Shellacking'." *National Public Radio.*
[79] Paul Harris and Ewan MacAskill. 2010. "US midterm election results herald new political era as Republicans take House." *The Guardian*.
[80] Filippo Gori. 2021. "The cost of political uncertainty: Lessons from the 2011 US debt ceiling crisis." *Vox EU.*
[81] Department of the Treasury. 2013. "The potential macroeconomic effect of debt ceiling brinkmanship."
[82] Ibid

> invested in stocks, lower stock prices reduce retirement security – from the second to the third quarter of 2011, retirement assets fell $800 billion. Businesses are also affected by stock prices because they rely on both debt and equity financing. When stock prices fall, investment or other spending to expand a business is more costly. The effects on households and businesses, moreover, are reinforcing. Less capacity and willingness of households to spend, when businesses have less incentive to invest, hire, and expand production, all lead to weaker economic activity.[83]

Certain businesses and households felt this brunt more than others. Banks use Treasuries as "risk-free" collateral in nearly all of their short-term lending and borrowing activities–a technical default would destroy this bedrock of the financial system. Because interest rates on Treasuries directly impact mortgage rates, the U.S. Department of the Treasury estimates that the 70 basis point jump in mortgage costs in the summer of 2011 cost the average household $100/month.[84]

The budget showdowns hardly ended with the conclusion of the debt ceiling crisis. To resolve the crisis, President Obama signed the compromise Budget Control Act of 2011 (often called "the Fiscal Cliff"), which applied an across-the-board government spending cut. The Congressional Budget Office estimated in 2012 that had the cuts gone into full effect (they were eventually partially reversed), the drop in growth would be so severe that it would send the country back into recession.[85] In total, they estimated the impact of the fiscal cliff to be 3.6 percent of GDP lost in 2013. While some of these changes were ultimately reversed in 2013 with the American Taxpayer Relief Act of 2013, many of the cuts were still enacted (called "the sequester"), including $42 billion in defense industry cuts and $11 billion in Medicare cuts. The bill cut reimbursements to physicians by 2%, and an American Hospital Association/American Medical Association study estimated that it cost the healthcare industry 500,000 jobs.[86] Pharmaceutical companies were also acutely harmed by the decimation of the FDA's budget for inspections, which slowed approval times for new drugs and devices.[87]

It is important to establish that these effects were *downstream of the change in partisan makeup of Congress*. Had either party–the Democrats or the Republicans–won unified control of the government, then these debt ceiling fights would likely have been avoided, as they had been in years past. These fights were also readily predictable prior to the Republican takeover. The Republicans ran first and foremost on a campaign of deficit spending and small government.[88]

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[83] Ibid
[84] Ibid
[85] Congressional Budget Office. 2012. "Economic Effects of Reducing the Fiscal Restraint That Is Scheduled to Occur in 2013."
[86] Katie Booth . 2013. "Impact of the Sequester on Health Care: By the Numbers." *Bill of Health*.
[87] Amy Filbin. 2013. "Funding Cutbacks at FDA: A Sequester Primer." *REDICA Systems*.
[88] Brian Weld. 2010. "A Pledge to America." *The Washington Post*.

The political press made it very clear prior that the debt ceiling would be a major showdown.[8990] The Republican "Pledge to America" (written by leader Kevin McCarthy) called for "strict budget caps" in order to prevent an increase in the debt, an obvious non-starter with Democratic leaders.[91] As Representative (and future Vice President) Mike Pence of Indiana said in late 2010, "There will be no compromise on stopping runaway spending, deficits and debt."[92] The Republican nominee for the Senate seat in Colorado Ken Buck continued, "When it comes to spending, I'm not compromising. I don't care who, what, when or where, I'm not compromising." The budget showdown emerged in early summer, just five months after Republicans first held a majority.

Importantly, it is *not* sufficient to offer an event contract on a government shutdown or default. After all, consumers and businesses lost billions of dollars *even though the government remained open and the government did not default on its debt*. Rather, the harms manifested because the partisan breakdown of Congress dramatically raised financial uncertainty, and financial markets tend to compensate for the additional risk. Suppose a retail investor with a mortgage tried to hedge their risk by buying a contract on whether the US will default on its debt. They will be insufficiently hedged as they lost hundreds per year even though the country did not default. Moreover, it is not plausible to anticipate the precise form that a resolution to the standoff would take far enough in the future to be useful to families and firms. It is well-known that cuts to spending and budgetary uncertainty would manifest, but policy-specific contracts require an impractical level of foresight As a result, political control contracts alone are sufficient to provide an adequate level of hedging.

Case Study from 2012: Political Gridlock and Health Care

While headlines in 2012 pitted incumbent President Barack Obama against former Massachusetts governor (and now Utah Senator) Mitt Romney, Congressional control had an equally dramatic effect on the economy. In particular, due to the flagging economic recovery, a major economic reform bill was expected to come before Congress. If the Democrats gained unified control, it was likely a major stimulus along the lines of the proposed American Jobs Act (with hundreds of billions in spending on schools and other traditional Democratic priorities) would have become law. Had Republicans gained unified control, major spending cuts and deregulation along the lines of the (successfully passed) JOBS Act would likely have been implemented. In particular, the Republican Party platform promised an end to taxes on capital gains, interest, and dividends for middle-class taxpayers, along with the end to the estate tax and

[89] Corey Dade. 2010. "Tea Party: From Fringe Element To Power Player." *NPR*.
[90] David Min. 2010. "The Big Freeze." *Center for American Progress*.
[91] Brian Weld. 2010. "A Pledge to America." *The Washington Post.*
[92] Andy Barr. 2010. "The GOP's no-compromise pledge." *Politico*.

the Alternative Minimum Tax.[93] Congressional candidates, along with nominee Mitt Romney, repeatedly promised a territorial system of taxation (which would exempt US multinationals from paying taxes on profits earned abroad) and a reduction in the overall corporate tax rate.

Perhaps the clearest contrast emerged in health care. Mitt Romney and Congressional Republicans repeatedly pledged to repeal President Obama's signature legislative achievement–the Affordable Care and Patient Protection Act of 2010 ("ACA", aka "Obamacare")--upon entering office. The aforementioned Pledge to America promised to repeal the ACA no fewer than three times.[94] The Republican-controlled House of Representatives voted to repeal the law no fewer than thirty-three times between 2011 and 2012.[95] By removing subsidies for tens of millions of Americans to buy insurance (in addition to removing the health insurance mandate), many existing health insurance companies would be harmed by such a proposal. For example, the CEO of the pharmaceutical company AmerisourceBergen specifically endorsed the Affordable Care Act on the belief that expanded insurance coverage would increase demand for his company's products.[96] Meanwhile, many medical technology companies–who are subject to a tax under the health care bill–would save millions of dollars per year from the Republican plan. Indeed, insurance and health care company stocks were volatile in the weeks up before the 2012 elections for fear of an eventual ACA repeal.[97] For example, hospital stocks fell 1-3% after Romney's strong first debate performance raised the probability of an eventual Republican victory.[98] As reported by Reuters,

> Romney's perceived win in the debate accounted for the negative outlook on hospital stocks on Thursday, Wells Fargo Securities analyst Gary Lieberman said. "Hospitals had been rallying on the likelihood of Obama's healthcare reform getting implemented as it looked like he had pulled ahead in polls," Lieberman said. But Romney's Wednesday performance showed the race was tightening, increasing the risk to hospital stocks, RBC Capital Markets analyst Frank Morgan said.[99]

Of course, the effects were not limited to corporations. Americans with pre-existing conditions would likely be harmed by the repeal, as the ACA required health insurance companies to offer health insurance to those with pre-existing conditions whereas prior to the bill it was often difficult to obtain affordable coverage. Meanwhile, community rating and age-banding limited premium increases for older adults, lowering their premiums. In contrast, a repeal might have benefited younger, healthier Americans who would no longer need to cross-subsidize older or

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[93] Republican Party. 2012. "Restoring the American Dream: Rebuilding the Economy and Creating Jobs." *The American Presidency Project*.
[94] Brian Weld. 2010. "A Pledge to America." The Washington Post.
[95] Wendell Potter. 2012. "Why insurers want ObamaCare's Medicaid business." *Tucson Sentinel*.
[96] David Sell. 2012. "Q&A with AmerisourceBergen CEO Steven Collis." *The Philadelphia Inquirer*.
[97] 2012. "Insurers, Hospital Stocks Register Presidential Election Jitters" *KHN*.
[98] Reuters staff. 2012. "Hospital stocks fall on Romney debate performance." *Reuters*.
[99] Ibid

sicker adults. Since an ACA repeal would also result in the removal of the requirement that health insurance companies cover a wide swathe of ailments such as smoking cessation devices, many younger or healthier Americans could see lower premiums by no longer having to pay for such items in their insurance. While the net effect of the bill remains hotly contested, 1) the economic effects of the bill and its repeal on specific sub-groups were identifiable, 2) the repeal of the Affordable Care Act was a predictable consequence of Republican control of government.[100][101][102]

Of course, because the voters delivered a split Congress, neither of these tax or health care repeal proposals became law. Voters largely restored the status quo ante, with Democrats controlling the Presidency and the Senate, while Republicans controlled the House of Representatives.[103][104] As a result, little legislative action happened, with Congress passing the fewest major bills in decades.[105][106]

While on the surface it appears as if there was no impact since control did not change, the truth tells a more nuanced story. Just a few percentage points of votes separated unified Democratic control from unified Republican control. Either of those scenarios would have altered the economic landscape for households and corporations alike. As such, a split government had economic consequences by foreclosing the possibility of unified control.

This example, as in the one above, precisely illustrates how hedging the partisan makeup of Congress is important for businesses and individuals alike. Insurance companies may use millions of customers from an ACA repeal, but households lose the insurance itself. In the status quo, that risk is *unhedgeable*. In fact, considering how the size of ACA subsidies downscale with income (i.e. people with lower incomes receive more benefits), the hedge is most valuable to those with the least income.

Case Study from 2016: Tax reform

Then candidate Donald J. Trump indicated his intention to dramatically change the tax code upon ascension to the nation's highest office. In August 2016, he unveiled a tax plan that he promised would be the biggest since the Reagan administration, offering tax cuts to Americans at every income level, "streamlining deductions" and reducing tax liability for US corporations.[107]

[100] Sara R. Collins, Stuart Guterman, Rachel Nuzum, Mark A. Zezza, Tracy Garber, and Jennie Smith. 2012. "Health Care in the 2012 Presidential Election: How the Obama and Romney Plans Stack Up." *The Commonwealth Fund*.
[101] Klein, Ezra. 2012. "The most important issue of this election: Obamacare." *The Washington Post*.
[102] Robert J. Blendon, John M. Benson, and Amanda Brulé. 2012. "Understanding Health Care in the 2012 Election." *The New England Journal of Medicine*.
[103] 2012. "President Map." *The New York Times*.
[104] 2012. "United States Congressional elections results, 2012." *Ballotpedia*.
[105] Philip Bump. 2014. "The 113th Congress is historically good at not passing bills." *The Washington Post*.
[106] Drew Desilver. 2014. "Congress continues its streak of passing few significant laws." *Pew Research Center*.
[107] John W. Schoen. 2016. "Trump touts sweeping, and costly, tax-cut plan." *CNBC*.

Market participants believed these promises were credible. As the New York Times reported, "the bounce-back in stocks [after the 2016 Republican victory] reflects the bet being made by many investors that Mr. Trump's promises to increase government spending, cut taxes and ease financial regulations will outweigh his anti-trade rhetoric."[108] Vox further reported, "The [stock market] rally started off powered by banking stocks, but it has spread across industries. It appears to be fueled by both improving economic indicators and a buoyant optimism about the prospects for sharp tax cuts and sweeping deregulation under unified Republican government in Washington. And it coincides with a spike in business confidence that can only be seen as a reaction to Trump's victory."[109]

Importantly, none of these tax changes could be enacted without the Republicans winning control of both the House of Representatives and the Senate. Democrats uniformly opposed such cuts and the bill–the Tax Cut and Jobs Act of 2017–was ultimately passed on a party-line basis with no Democrats in the Senate supporting its passage.[110][111] As a result, unified control over government was a prerequisite to the passage of the tax cut bill. There were two primary channels by which these taxes impacted financial outcomes for businesses.

First, lower headline rates meant that corporations can retain more of their profits as opposed to disbursing them in taxes. For some corporations, slashing the top corporate tax rate from its previous peak at 35% to its current top rate of 21% saved the bottom line billions of dollars.[112][113] As a study by economists Javier Garcia-Bernando, Petr Jansky and Gabriel Zucman found, the Act caused a "10 percentage point decline in the effective tax rate on domestic profits".[114] As the Congressional Research Service wrote,

> The Act would reduce individual income taxes by $65 billion, corporate income taxes by $94 billion, and other taxes by $3 billion, for a total reduction of $163 billion in FY2018… From 2017 to 2018, the estimated average corporate tax rate fell from 23.4% to 12.1% and individual income taxes as a percentage of personal income fell slightly from 9.6% to 9.2%.[115]

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[108] Landon Thomas, Jr. 2016. "Why Stock Markets, Initially Shaken, Went Up After Trump's Victory." *The New York Times*.
[109] Jim Tankersley. 2017. "Why the stock market loves Donald Trump." *Vox*.
[110] Scott Horsley. 2016. "The Issues: Explaining Hillary Clinton's And Donald Trump's Tax Plans." *NPR*.
[111] H.R.1, 115th Congress. https://www.congress.gov/bill/115th-congress/house-bill/1/actions
[112] 2020. "How does the corporate income tax work?" *Tax Policy Center*.
[113] 2021. "Big Businesses That Banked Tens of Billions From Trump Tax Cuts Now Lobbying On Plans To Make Them Pay Their Fair Share." *Accountable.us*
[114] Javier Garcia-Bernardo, Petr Janský, and Gabriel Zucman. "Did the Tax Cuts and Jobs Act Reduce Profit Shifting by US Multinational Companies?"
[115] Jane G. Gravelle and Donald J. Marples. 2019. "The Economic Effects of the 2017 Tax Revision: Preliminary Observations." *Congressional Research Service*.

Second, changes in the tax treatment of capital asset depreciation can be decisive for capital-intensive firms. As a candidate, Donald Trump promised to allow firms to expense the full value of their investments in the year they made them, as opposed to writing off the cost over the lifespan of the asset.[116] For firms with large capital expenditures, immediate expensing could allow them to recoup millions in tax savings immediately, instead of slowly over time. Due to the time value of money (a dollar today is worth more than a dollar ten years from now) and the liquidity benefits of being able to reduce tax expenditures in the same year one had to spend, the promised expensing reform was transformative for capital-intensive industries, making more investments profitable than before.[117] The Congressional Research Service wrote further,

> Estimates indicate that the user cost of capital for equipment declined by 2.7% and the user cost of structures declined by 11.7% … than that of structures primarily because more of the cost for equipment is for depreciation.[118]

The Institution of Tax and Economic Policy estimated that the bonus depreciation alone saved twenty corporations more than $26 billion in 2018 and 2019.[119] Some companies that invest in large amounts of equipment, vehicles and machinery, such as Amazon, EOG (formerly Enron Oil and Gas), Delta Airlines, General Motors, FedEx, UPS, Intel, United Airlines, and Verizon saw more than $1 billion in savings each from that single provision.

Even non-corporations were dramatically impacted by the change in the tax code. The bill lowered the limit of mortgage deductibility to $750,000 and eliminated the deductibility for home equity interest.[120] Meanwhile, the deduction for state and local taxes was capped at $10,000, substantially raising taxes for those in high-tax jurisdictions such as California, New York and New Jersey. Meanwhile, for parents and those who do not itemize, the near doubling of the standard deduction and child tax credit substantially reduced the taxes they needed to pay. One Niskanen Center report estimates that the changes to the child tax credit lifted 750,000 people out of poverty, of which roughly half were children.[121] According to an analysis by the Tax Foundation, people earning $20,000-$30,000 saved an additional 13.5% on their taxes each year from the tax reform. As a result, the hedge is valuable not just to large corporations, but to regular American families as well.

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[116] Steven M. Rosenthal. 2016. "Making tax shelters great again!" *Tax Policy Center.*
[117] Anna Tyger. 2019. "New Evidence on the Benefits of Full Expensing." *Tax Policy Center*.
[118] Jane G. Gravelle and Donald J. Marples. 2019. "The Economic Effects of the 2017 Tax Revision: Preliminary Observations." Congressional Research Service.
[119] Matthew Gardner and Steve Wamhoff. 2020. "Depreciation Breaks Have Saved 20 Major Corporations $26.5 Billion Over Past Two Years." *Institute on Taxation and Economic Policy.*
[120] Joseph A. Bellinghieri. "Key provisions of the Tax Cuts and Jobs Act." *MacElree Harvey*.
[121] Robert Orr. 2019. "The impact of the 2017 Child Tax Credit expansion was larger than anyone expected." *Niskanen Center*.

This analysis is not merely with the benefit of hindsight: these proposals and their downstream effects on corporations were well-identified prior to the change in government. Economic newsletters were advising their clientele to buy bank stocks as a proxy for a Republican victory, as they would benefit most from the proposed tax plan.[122] In short, Republican control was a *necessary prerequisite to the passage of a major tax bill associated with major economic effects*. These effects were identified by the political press and market participants well in advance.

Case Study from 2020: Stimulus Checks

After the dust cleared in 2020, it became clear that Joe Biden had won the Presidency and the Democrats had won the House of Representatives. However, Senate control was dead-locked: the Democrats had won 48 seats to the Republicans' 50, with two races in Georgia heading to a run-off. If Democrats won both, they would control the Senate (due to Vice President Kamala Harris holding the tiebreak vote).

Control of the Senate would be pivotal to President Biden's agenda. Democrats made the stakes clear: if they controlled the Senate, they would immediately use their trifecta to pass a major COVID-19 relief bill that includes $2,000 stimulus checks for nearly all Americans.[123][124][125] If the Republicans won, those checks were unlikely (Senate Republican leader Mitch McConnell even called them "socialism for rich people" before blocking a vote on them in late 2020), as was confirmed when the bill (the American Rescue Plan Act) was ultimately passed on a pure party-line vote.[126][127][128]

While the ultimate stimulus amount was pared down to $1,400 per person, the bill also contained provisions such as $350 billion in aid to state and local governments, a dramatic expansion in the child tax credit and an extension of emergency unemployment insurance policies that had been enacted earlier during the pandemic.[129] For millions of families with children or earning under $75,000 per year (the income threshold for the stimulus checks), control of the Senate thus had a predictable impact on their household finances. Along with those who were unemployed, or had

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[122] Phil Kuntz. 2016. "4 days to go: Here's the US election cheatsheet for financial markets." *The Economic Times*.
[123] Kate Sullivan. 2021. "Biden says electing Georgia's Ossoff and Warnock would lead to $2,000 stimulus checks." *CNN*.
[124] Sahil Kapur. 2021. "In Georgia, Democrats close with populist pitch vowing $2,000 stimulus checks." *NBC News*.
[125] Lance Lambert and Anne Sraders. 2021. "Democrats plan to use Senate win to pass $2,000 stimulus checks." *Fortune*.
[126] Burgess Everett and Quint Forgey. 2020. "McConnell: House's $2,000 stimulus checks are 'socialism for rich'." *Politico*.
[127] Burgess Everett. 2020. "McConnell and GOP reject House's $2,000 stimulus checks." *Politico*.
[128] H.R. 1319, 117th Congress. https://www.congress.gov/bill/117th-congress/house-bill/1319/actions
[129] Erik Haagansen. 2021. "American Rescue Plan (Biden's $1.9 Trillion Stimulus Package)." *Investopedia*.

a job dependent on contracts with state and local governments, the Democratic trifecta may have been a factor in the drop in household debt and child poverty in the first half of 2021.[130][131]

As in the previous examples, these tradeoffs were known prior to the Democratic takeover. Senate Republican leadership was opposed to the American Rescue Plan Act and made that opposition plain. They not only opposed the checks, but the aid to states as well.[132] Reasonable voters could reasonably infer that a Republican victory meant either no or a much smaller rescue bill. Control of the legislative branch thus has an impact on millions of Americans' financial situations.

[130] Household Debt Service Payments as a Percent of Disposable Personal Income. *Federal Reserve Economic Data*. https://fred.stlouisfed.org/series/TDSP
[131] Zachary Parolina, Sophie Collyera, Megan A. Currana and Christopher Wimer. 2021. "Monthly Poverty Rates among Children after the Expansion of the Child Tax Credit." *Poverty and Social Policy Brief.*
[132] Jason Lemon. 2020. "N.Y. Congressman Calls Out McConnell for Opposing COVID Aid to States." *Newsweek*.

APPENDIX C (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.[133]

[133] https://www.congress.gov/about

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 stolen. 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.

APPENDIX D (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. 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 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 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.

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.

(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 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, 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. Leaking results early in order to trade on the contract would also be very unlikely.

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."[134][135] 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.[136]

Today, such contracts remain 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.

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[134] Paul Rhode and Coleman Strumpf. 2003. "Historical Prediction Markets: Wagering on Presidential Elections".
[135]Paul Rhode and Coleman Strumpf. 2012. "The Long History of Political Betting Markets: An International Perspective."
[136] Paul Rhode and Coleman Strumpf. 2003. "Historical Prediction Markets: Wagering on Presidential Elections".

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."[137] 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.[138] 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."[139]

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. Trillions in stock value are deeply dependent on public policy outcomes; 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. Campaigns and party apparatuses have access to levels of cash-on-hand rarely seen in other contexts. No country's citizens spend more on its elections than the United States. The campaigns of Joe Biden and Donald Trump, and their respective political parties, fundraised almost $4 billion during the 2020 U.S. presidential campaign.[140] In weak democracies, political parties frequently use public and private funds to buy citizens' votes, which is not something that

[137] Paul Rhode and Koleman Strumpf. 2005. "Manipulating Political Stock Markets: A Field Experiment and a Century of Observational Data."
[138] Robin Hanson and Ryan Oprea. 2008. "A Manipulator Can Aid Prediction Market Accuracy." *Economica*.
[139] Justin Wolfers and Eric Zitzewitz. 2006. "Prediction Markets in Theory and Practice".
[140] Sean McMinn. 2020. "Money Tracker: How Much Trump And Biden Have Raised In The 2020 Election." *National Public Radio*.

is seen in the United States.[141][142][143] Despite the money, prestige, and political importance at stake in federal elections, attempts at manipulation that would affect the market on political control have not been observed.

Importantly, the fact that these contracts are *already* traded on Commission-sanctioned unregistered trading 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 awarded PredictIt, a new unregistered trading venue dedicated to election and political event contracts, with a no-action letter. Since then, it has hosted an enormous amount of trading. As noted in the introduction, political control contracts on PredictIt have traded more than $100 million in volume. As of 2022, PredictIt has more than 250,000 registered users and more than one billion contracts traded.[144][145]

This information--that hundreds of millions of dollars can be traded on political control contracts without creating manipulation concerns--was not available to the Commission the last time it considered similar event contracts in 2012.[146] Although the Commission also awarded a no-action letter to another political contract trading venue, the Iowa Electronics Market, in 1992, IEM is smaller and harder to access for individuals not associated with the University of Iowa. Now, far more money is known to have been traded on election outcomes. Major reporting outlets cite PredictIt odds to give media consumers information about elections.[147][148]

Americans can also readily access cryptocurrency-based decentralized exchanges (DEXes) which offer political control markets on platforms such as Polymarket and Omen.[149][150] Polymarket's markets on Congressional control have traded millions.[151] 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

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[141] Valeria Brusco, Marcelo Nazareno and Susan C. Stokes. 2004. "Vote buying in Argentina." *The Latin American Studies Association.*
[142] Michael Bratton. 2008. "Vote buying and violence in Nigerian election campaigns." *Electoral Studies.*
[143] Ezequiel Gonzalez-Ocantos, Chad Kiewiet de Jonge, Carlos Meléndez, Javier Osorio, and David W. Nickerson. 2011. "Vote Buying and Social Desirability Bias: Experimental Evidence from Nicaragua." *American Journal of Political Science.*
[144] PredictIt. https://www.predictit.org/insight/aHR0cHM6Ly9hbmFseXNpcy5wcmVkaWN0aXQub3JnL3Bvc3QvMTg4NzQ3ODgwMDQzL2EtcHJlZGljdGFibGUtbmV3c2xldHRlci0xMTExOSNtb2JpbGU=
[145] Former employee, Will Jennings', public LinkedIn profile. https://www.linkedin.com/in/will-jennings-pi/
[146] Nadex order. 2012. CFTC. https://www.cftc.gov/sites/default/files/idc/groups/public/@rulesandproducts/documents/ifdocs/nadexorder040212.pdf
[147] Jonathan Ponciano. 2020. "Online Betting Markets Are More Bullish On A Trump Victory Than Polls, Here's Why." *Forbes*.
[148] Amy Tennery. 2016. "Trump's chance of victory skyrockets on betting exchanges, online market." *Reuters*.
[149] Polymarket. https://polymarket.com/market/will-gavin-newsom-be-governor-of-california-on-december-31-2021
[150] Omen.eth. https://omen.eth.link/#/0x95b2271039b020aba31b933039e042b60b063800/finalize
[151] Polymarket. https://polymarket.com/market/will-trump-win-the-2020-us-presidential-election

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. There are no indications that the markets caused or induced an attempt to manipulate elections, let alone a successful manipulation.

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.

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.

APPENDIX E (CONFIDENTIAL) - ENGAGEMENT TIMELINE

Late 2021 ~ Mar 28, 2022	Kalshi informed DMO that it was meeting with the Hill regarding the contracts
Mar 28	Contract and analysis sent to DMO
Apr 7	Kalshi meets with DMO
Apr 13	Kalshi meets with DMO Kalshi meets with Chairman's office
Apr 26	Kalshi requests meeting with DMO Director
Apr 28	Kalshi follows up on meeting request with DMO Director
May 2	Kalshi meets with Commissioner Goldsmith-Romero's office
May 3	Kalshi follows up on meeting request with DMO
May 4	Kalshi meets Chairman's office. Chairman's office requests follow up Kalshi requests follow up meeting with Chairman's office as instructed
May 5	Kalshi meets with Commissioner Pham

May 6	Kalshi follows up on meeting request with Chairman's office
May 11	Kalshi has second meeting with the Chairman's office
	Kalshi meets with Commissioner Goldsmith-Romero
May 12	Kalshi certifies a mortgage rate contract, and then pauses all certifications for 47 days while DMO considers the contracts
May 16	Kalshi meets with Commissioner Mersinger's office
May 18	Kalshi meets with Commissioner Pham's office
	Kalshi meets with Commissioner Johnson's office
May 24	DMO sends Kalshi numerous questions on its political control contracts
May 25	Kalshi's counsel (Jonathan Marcus, Reed Smith) sends analysis to DMO
May 26	Kalshi responds to DMO questions
May 31	Kalshi's counsel (Dan Davis, Katten) sends analysis to DMO
Jun 1	Kalshi requests short call to update Chairman's office on timing. Kalshi instructed to continue engaging with DMO instead
Jun 2	DMO sends an email specifically about the CVF to Kalshi
Jun 3	Kalshi responds to DMO's questions about the CVF and provides the amended CVF

Jun 7	Kalshi follows up on meeting request with DMO Director
Jun 9	Kalshi's counsel speaks with DMO about the CVF
Jun 10	Kalshi's counsel sends CVF analysis to DMO
Jun 16	Kalshi meets with DMO re the CVF
Jun 17	Kalshi requests meeting with Chairman's office
Jun 24	Kalshi meets with DMO Director in the DMO office
Jun 28	Kalshi certifies hurricane contracts, the first contracts in 47 days
Jun 29	Kalshi meets with Chairman. Kalshi instructed to work with Chairman's office Kalshi requests meeting with Chairman's office, provides all aggregated materials
Jul 8	Kalshi's announced "drop dead date" for filing the contracts. Postponed to accommodate scheduling of Chairman's office meeting
Jul 12	Kalshi meets with Chairman's office to discuss timing
Jul 13	Kalshi meets with Chairman's office to discuss feedback. Chairman's office requests an update following Kalshi's meeting that night with Hill
Jul 14	Kalshi updates Chairman's office as requested. Meeting set for 7/18 for further feedback from the Chairman's office
Jul 18	Chairman's office cancels meeting

APPENDIX F (CONFIDENTIAL) - COMMISSION JURISDICTION AND THE SPECIAL RULE FOR EVENT CONTRACT

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 40.3(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" 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. 7 U.S.C § 7a-2(c)(5)(C)(i).[152] 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,[153] 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. 17 C.F.R. § 40.11(c).

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[152] 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).

[153] 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").

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 assasination; 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.[154] Thus, the statute is clear that an event contract "involves" an 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. .

[154] 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", and single statutory statement, 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.

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.[155]

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, assasination, war, or a game. As such, political control contracts are not included in the narrow reach of the CEA's special rule for certain, enumerated activities and the rule and relevant regulations (17 C.F.R. § 40.11) does not apply.[156]

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

Additional analysis on the applicability of the special rule is included in appendices F.1 and F.2. Appendix F.1 is an analysis from the Exchange's outside counsel Jonathan Marcus. Appendix F.2 is an analysis from the Exchange's outside counsel Dan Davis.

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[155] 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.

[156] 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, 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.

APPENDIX F.1 (CONFIDENTIAL) - JONATHAN MARCUS ANALYSIS

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Confidential Treatment Requested by KalshiEX LLC

May 25, 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

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/ifdocs/nadexorder040212.pdf.

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/CommissionRulemakingExplained/index.htm#_ftn1.

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

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.

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[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).

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:

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[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/.

> …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, various federal laws that address – and largely prohibit – gambling, specifically carve out regulated derivatives products from their definitions of "bet or wager," highlighting that Congress views the two types of transactions as fundamentally distinct. For example, 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.

The Bank Secrecy Act's definition of "bet or wager," which the Commission relied upon in its Nadex Order,[13] has a carve-out for derivatives products identical to UIGEA's.[14]

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] *Supra* note 4 at 3.
[14] 31 U.S.C. § 5362(1)(E) (2006).

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]

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[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").

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 Marcus

Jonathan L. Marcus

Cc: Eliezer Mishory
Chief Regulatory Officer and Counsel, Kalshi

APPENDIX F.2 (CONFIDENTIAL) - DAN DAVIS ANALYSIS

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Confidential Treatment Requested by KalshiEX LLC

May 31, 2022

Elie Mishory
KalshiEx LLC
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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.

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.

"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).

> **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).

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

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[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."

of the contract. Thus, the text and structure of Section 5c(c)(5)(C) clearly and meaningful 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

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[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.

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.

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[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.

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 Order[24] 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

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[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

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

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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.").

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,"

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[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).

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.

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[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).

Katten

Please let me know if you need anything further.

Sincerely,

Daniel J. Davis

Daniel J. Davis

DJD:dml

APPENDIX G (CONFIDENTIAL) - FEES

As instructed by the Secretariat, the Exchange paid a fee of $6,000 via the CFTC's pay.gov portal. A copy of the receipt is attached.

Pay.gov

MENU

Receipt - Commodity Futures Trading Commission(CFTC)Miscellaneous Form

Payment Activity

Receipt

Your payment has been submitted to Pay.gov and the details are below. If you have any questions regarding this payment, please email 9-AMZ-AR-CFTC@faa.gov, please.

Tracking Information

Pay.gov Tracking ID: 270UR42L

Agency Tracking ID: 76268019171

Form Name: Commodity Futures Trading Commission(CFTC)Miscellaneous Form

Application Name: Commodity Futures Trading Commission (CFTC) Misc. Form

Payment Information

Payment Type: Debit or credit card

Payment Amount: $6,000.00

Transaction Date: 07/20/2022 12:09:03 AM EDT

Payment Date: 07/20/2022

Account Information

Cardholder Name: Hadassah Mishory

Card Type: Visa

Card Number: **********7093

Pay.gov

MENU

Receipt - Commodity Futures Trading Commission(CFTC)Miscellaneous Form

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Account Information

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Card Type: Visa

Card Number: **********7093

Kalshi

FOIA CONFIDENTIAL TREATMENT REQUESTED by KalshiEX LLC – Pursuant to 17 C.F.R. §§ 40.8 and 145.9

Assistant Secretary of the Commission
for FOI, Privacy and Sunshine Acts Compliance
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: FOIA Confidential Treatment Request (Detailed Written Justification of FOIA Confidential Treatment Request)

Dear Sir or Madam:

KalshiEX LLC ("Kalshi") hereby respectfully requests that the Commodity Futures Trading Commission (the "CFTC") accord confidential treatment under 17 C.F.R. §§ 40.8 and 145.9 to the confidential material transmitted today with this letter that are marked confidential, and all information derived therefrom (collectively, the "Confidential Information"). Pursuant to Commission Regulation 145.9(d)(4), please consider that this cover sheet has been clearly marked "FOIA Confidential Treatment Requested by KalshiEX LLC" and is securely attached to the group of records submitted for which confidential treatment is requested.

This request for confidential treatment is made pursuant to 17 C.F.R. §145.9(d)(1) because Kalshi believes that the Confidential Information is covered by one or more exemptions in the Freedom of Information Act (the "FOIA") (5 U.S.C. §552(b)) and is therefore exempt from the CFTC's public disclosure requirements pursuant to 17 C.F.R. §145.5. In particular, 5 U.S.C. §552(b)(4) ("Exemption 4") and 17 C.F.R. §145.9(d)(1)(ii) exempts disclosure that would reveal the Kalshi's trade secrets or confidential commercial or financial information. Kalshi believes that the Confidential Information contains confidential commercial and financial information as well as proprietary information regarding its legal and business analyses and research that

should be protected from public disclosure pursuant to this exemption. Confidential treatment is requested for a period of five years.

Judicial analysis of Exemption 4 has found that there is a presumption of confidentiality for commercial information that is (1) provided voluntarily and (2) is of a kind the provider would not customarily make available to the public. See *Critical Mass Energy Project v. Nuclear Regulatory Commission*, 975 F.2d 871, 878 (D.C. Cir. 1992) (en banc); see also *Center for Auto Safely v. National Highway Traffic Safety Administration*, 244 F.3d 144, 147 (D.C. Cir. 2001) (applying the tests detailed in Critical Mass). Kalshi provided the Confidential Information to the Commission voluntarily in order to demonstrate to the Commission the Program's compliance with the CEA and the Commission Regulations. Notwithstanding the presumption of confidentiality, the confidential information would still be considered "confidential" because Kalshi would not disclose it to the public and its disclosure would cause substantial harm to Kalshi's competitive position. The information set out in the confidential appendices was developed by Kalshi at significant cost and over a substantial period of time. Further, the Confidential Information is purely internal analyses that Kalshi would not customarily make available to the public. Additionally, the Confidential Information would give Kalshi's competitors insights into Kalshi's processes and proprietary reserach, which would have the effect of placing Kalshi at a significant competitive disadvantage in light of the time, effort, and capital that Kalshi expended developing that material. Publication of this material would have the deleterious effect of stifling innovation; after all, if registrants are stripped of the benefits of innovation there is no incentive to innovate.

FOIA was enacted to facilitate the disclosure of information to the public, but was clearly not intended to allow business competitors to avail themselves of valuable confidential information, especially when "competition in business turns on the relative costs and opportunities faced by members of the same industry." *Worthington Compressors v. Costle*, 662 F.2d 45, 51 (D.C. Cir. 1981). In *Gulf & Western Industries, Inc. v. United States*, 615 F.2d 527 (D.C. Cir. 1979), the Court of Appeals concluded that information is confidential for purposes of FOIA if (1) it is not of the type normally released to the public by the Kalshi and (2) the information is of the type that would cause substantial competitive harm if released. There is no requirement that "competitive harm" be established by a showing of actual competitive harm. Rather, "actual competition and the likelihood of substantial competitive injury is all that needs to be shown." *Gulf & Western*, 615 F.2d at 530. Thus, in *National Parks and Conservation Association v. Kleppe*, 547 F.2d 673 (D.C. Cir. 1976), the Court of Appeals concluded that the disclosure of certain financial information, including costs and price-related items, was likely to cause substantial harm to the disclosing party's competitive position. When applying the "substantial competitive harm test," courts "[c]onsider how valuable the information will be to the requesting competitors and how much this gain will damage the submitter." *Worthington Compressors*, 662 F.2d at 51. It is clear that the FOIA exemption was intended to prevent the fundamental unfairness that can result from one side having confidential information about the other in a business context. *Cf. National Parks*, 547 F.2d at 678 n.18. The confidential information is valuable commercially because it took significant time and at substantial cost to develop.

If the Commission or its staff transmits any of the Confidential Submission to another federal agency, Kalshi requests that you forward a copy of this letter to any such agency with the Submission and further requests that you advise any such agency that Kalshi has requested that this material be accorded confidential treatment.

The requests set forth in the preceding paragraphs also apply to any memoranda, notes, transcripts or other writings of any sort whatsoever that are made by, or at the request of, any employee of the Commission (or any other federal agency) and which (1) incorporate, include or relate to any aspect of the Confidential Submission; or (2) refer to any conference, meeting, or telephone conversation between Kalshi, its current or former employees, representatives, agents, auditors or counsel on the one hand and employees of the Commission (or any other government agency) on the other, relating to the Confidential Submission.

This request is not to be construed as a waiver of any other protection from disclosure or confidential treatment accorded by law, and Kalshi will rely on and invoke any such confidentiality protection. Kalshi requests that the CFTC advise the undersigned, pursuant to 17 C.F.R. §145.9(e)(1), in advance of any disclosure of the Confidential Information pursuant to the FOIA, so that this request for confidential treatment may be substantiated.

If you should have any questions or comments or require further information, please do not hesitate to contact the undersigned at emishory@kalshi.com or (443) 839-3192.

Yours,

Elie Mishory
Chief Regulatory Officer
KalshiEX LLC
emishory@kalshi.com

Kalshi

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"), codified[1] 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

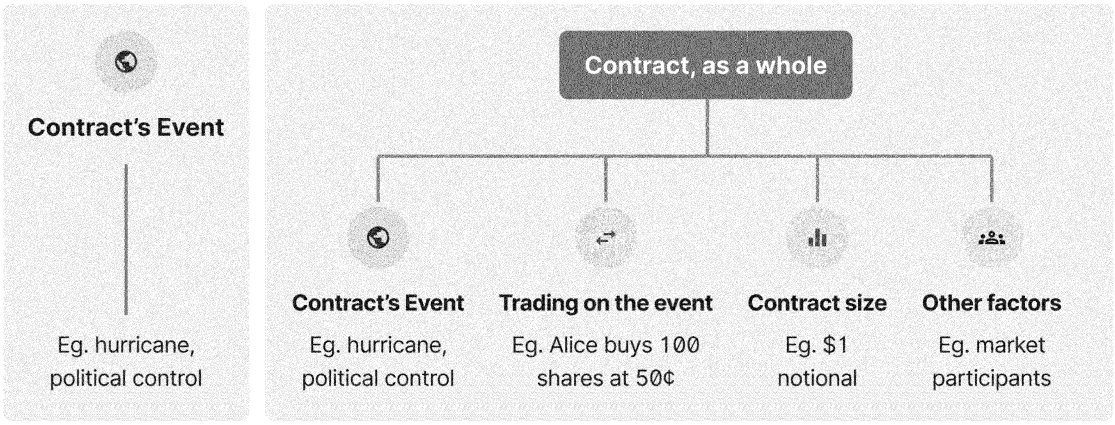
The phrase "contract, considered as a whole" refers to a broad view of a contract and all factors that surround or are a part of the contract. For example, this would include the activity of buying and selling the contract ie. the activity of *trading* the contract, the information embedded in the contract's 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 statute[6] 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 al 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 involves[13] 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;

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[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, *argunedo*, 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.

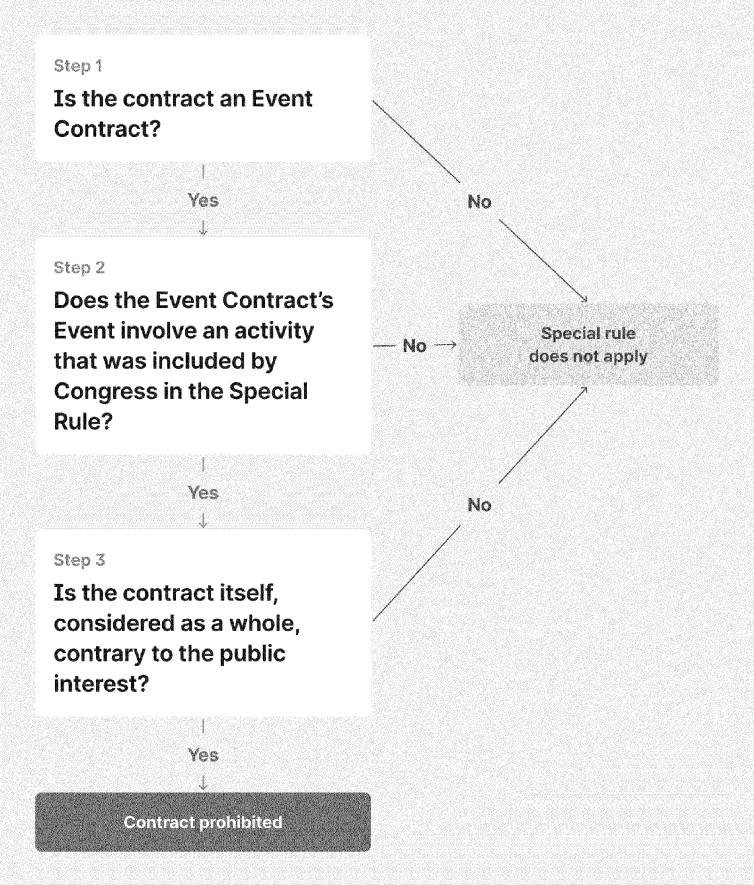
Step 3: Is the contract itself, considered as a whole, contrary to the public interest? If no, the contract is not prohibited. If yes, the contract is prohibited.

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.")



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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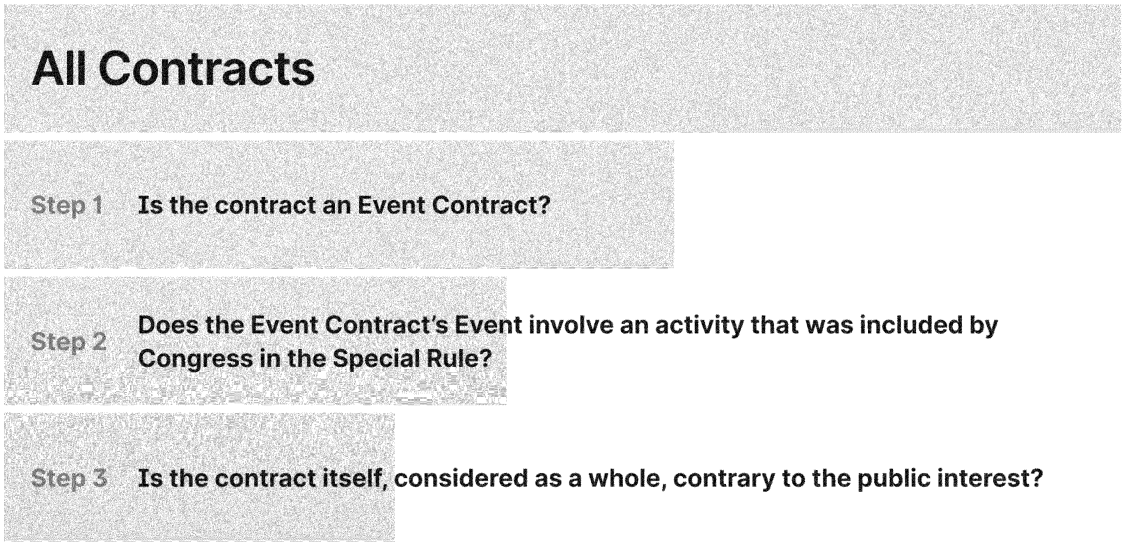

To further explain the role of Step Three, Congress did not prohibit an Event Contract whose Event involves an activity listed in the Special Rule.. It is possible that an Event Contract's Event involves an activity listed in the Special Rule but the Commission does not determine that the contract, considered 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]

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[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."

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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 neverthless 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.

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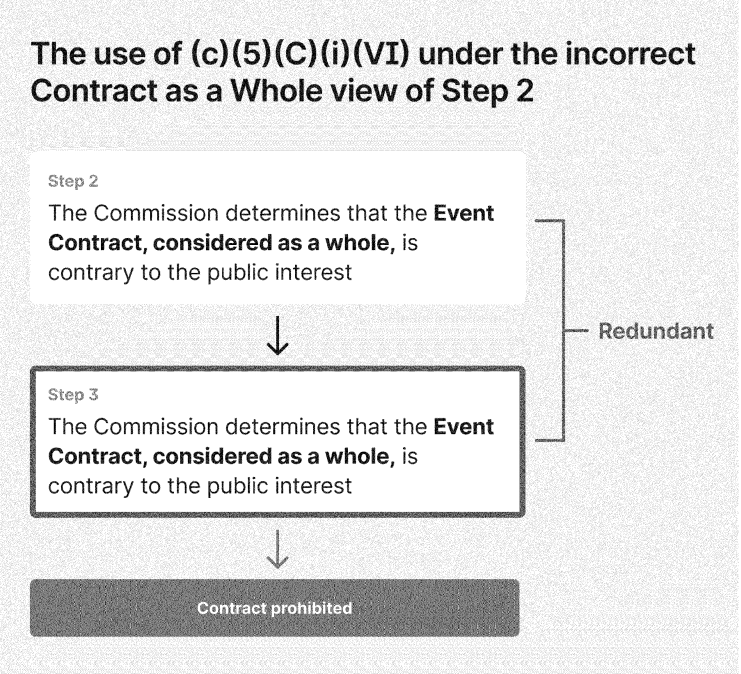
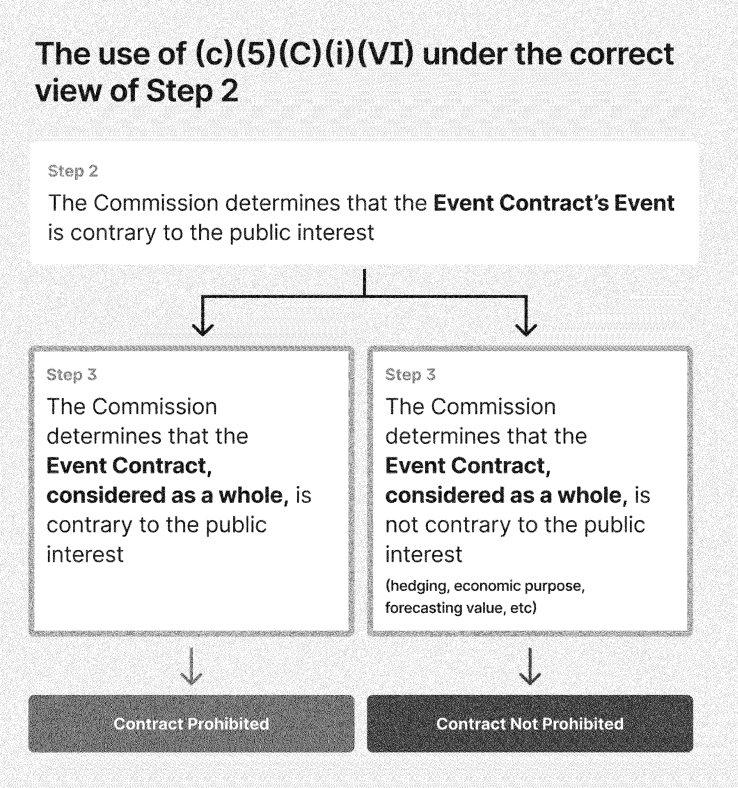

The use of (c)(5)(C)(i)(VI) under the incorrect Contract as a Whole view of Step 2
Step 2
The Commission determines that the **Event Contract, considered as a whole,** is contrary to the public interest
Redundant
Step 3
The Commission determines that the **Event Contract, considered as a whole,** is contrary to the public interest
Contract prohibited


The use of (c)(5)(C)(i)(VI) under the correct view of Step 2
Step 2
The Commission determines that the **Event Contract's Event** is contrary to the public interest
Step 3
The Commission determines that the **Event Contract, considered as a whole,** is contrary to the public interest
Contract Prohibited
Step 3
The Commission determines that the **Event Contract, considered as a whole,** is not contrary to the public interest
(hedging, economic purpose, forecasting value, etc)
Contract Not Prohibited

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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 assasination) 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 Order[24] ("*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.

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[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.

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[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.

Kalshi

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

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/ifdocs/nadexorder040212.pdf.

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/CommissionRulemakingExplained/index.htm#_ftn1.

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

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.

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[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).

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:

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[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/.

> …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.

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]

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[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/berkovitzstatement040721 ("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 Marcus

Jonathan L. Marcus

Cc: Eliezer Mishory
Chief Regulatory Officer and Counsel, Kalshi

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May 31, 2022

Elie Mishory
KalshiEx LLC
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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.

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.

"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,**

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[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).

> **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).

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

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[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."

of the contract. Thus, the text and structure of Section 5c(c)(5)(C) clearly and meaningful 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

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[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.

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.

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[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.

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 Order[24] 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

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[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

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

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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.").

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,"

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[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).

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.

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[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).

Please let me know if you need anything further.

Sincerely,

Daniel J. Davis

Daniel J. Davis

DJD:dml

November 22, 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: KalshiEX LLC – Request for an extension of time under Commission Regulation 40.11(c)(2) with regard to the "Will <party> be in control of the <chamber of Congress>?" contract

Dear Sir or Madam,

Pursuant to section 40.11(c)(2) of the regulations of the Commodity Futures Trading Commission, KalshiEX LLC (Kalshi) hereby requests an extension to the Commission's review period under section 40.11 regarding the "Will <party> be in control of the <chamber of Congress>?" contract until January 23, 2023.

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

Sincerely,

Eliezer Mishory

Elie Mishory
Chief Regulatory Officer
KalshiEX LLC
emishory@kalshi.com

January 6, 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 – Request for an extension of time under Commission Regulation 40.11(c)(2) with regard to the "Will <party> be in control of the <chamber of Congress>?" contract

Dear Sir or Madam,

Pursuant to section 40.11(c)(2) of the regulations of the Commodity Futures Trading Commission, KalshiEX LLC (Kalshi) hereby requests an extension to the Commission's review period under section 40.11 regarding the "Will <party> be in control of the <chamber of Congress>?" contract until March 23, 2023.

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

Sincerely,

Eliezer Mishory

Elie Mishory
Chief Regulatory Officer
KalshiEX LLC
emishory@kalshi.com

March 15, 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 – Request for an extension of time under Commission Regulation 40.11(c)(2) with regard to the "Will <party> be in control of the <chamber of Congress>?" contract

Dear Sir or Madam,

Pursuant to section 40.11(c)(2) of the regulations of the Commodity Futures Trading Commission, KalshiEX LLC (Kalshi) hereby requests an extension to the Commission's review period under section 40.11 regarding the "Will <party> be in control of the <chamber of Congress>?" contract until May 22, 2023.

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

Sincerely,

Eliezer Mishory

Elie Mishory
Chief Regulatory Officer
KalshiEX LLC
emishory@kalshi.com

May 16, 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 – Withdrawal of the "Will <party> be in control of the <chamber of Congress>?" contract

Dear Sir or Madam,

KalshiEX LLC (Kalshi) hereby notifies the Commodity Futures Trading Commission that it is withdrawing the "Will <party> be in control of the <chamber of Congress>?".

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

Sincerely,

Eliezer Mishory

Elie Mishory
Chief Regulatory Officer
KalshiEX LLC
emishory@kalshi.com

I write to voice support for KalshiEX LLC's filing to list political control markets.

For the last 15 years, I have worked at JPMorgan, and I am currently a Managing Director in its private wealth management division. I noticed that one of the questions offered by the CFTC was asking whether elections have sufficiently predictable economic consequences in order to justify risk management products like that which Kalshi is proposing. I have deep experience with this problem in my time working at JPMorgan and I am happy to write detailing that in support of the contract's approval.

I have intimate experience with this. 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).

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. For example, here we detailed how the results of the 2018 midterm cycles impacted financial markets. Here's another example from another bank, Morgan Stanley where they provided a brief guide about how to manage risk before the current midterm elections.

Many banks' research often relies on prediction markets (for an example, check here). However, current prediction markets have a number of constraints that prevent them from operating with the best price accuracy possible. Permitting this contract would improve our and the public's ability to forecast and manage the risks that really matter to them. There is great social value in these products.

Risk stemming from the outcomes of changes in Congressional control (or the lack thereof) imply significant risks for holders of stocks, bonds, derivative products, and recipients of particular cash flows. Congress has broad power to affect changes in tax policy, government benefits, regulations, bureaucratic appointments, foreign and trade policy, immigration policy, and so many other facets that deeply affect industry. Although politicians hardly always keep their promises, markets consistently move based on changes in election expectations and outcomes. Far before policies come into place, deals are made on the basis of future expectations regarding policy, even if those expectations don't always bear fruit (though they frequently do). If the private market is already trading and pricing this risk, it follows that such a risk is sufficiently predictable and a risk management product like Kalshi's would be socially valuable.

Large banks offer these to high networth and ultra rich clients, Kalshi is not the first to wonder how impactful it would be to bring these capabilities to the rest of the population who does not have access to desks at large banks and private wealth management services: we've been thinking about these types of instruments for a long time.

Given my statement, and the large extent of hedging and pricing based on the expected policy outcomes of elections, it would be very strange for the CFTC to find that election contracts do not have regular and predictable hedging use cases. Not a single person in the industry would tell you different.

I encourage the CFTC to swiftly approve Kalshi's contract in order to complete markets and promote effective and innovative risk management tools.

Angelo Lisboa

Kalshi

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"), codified[1] 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.

Kalshi

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.

Kalshi

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 statute[6] 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).

Kalshi

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 al 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 involves[13] 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;

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[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, *argunedo*, 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.

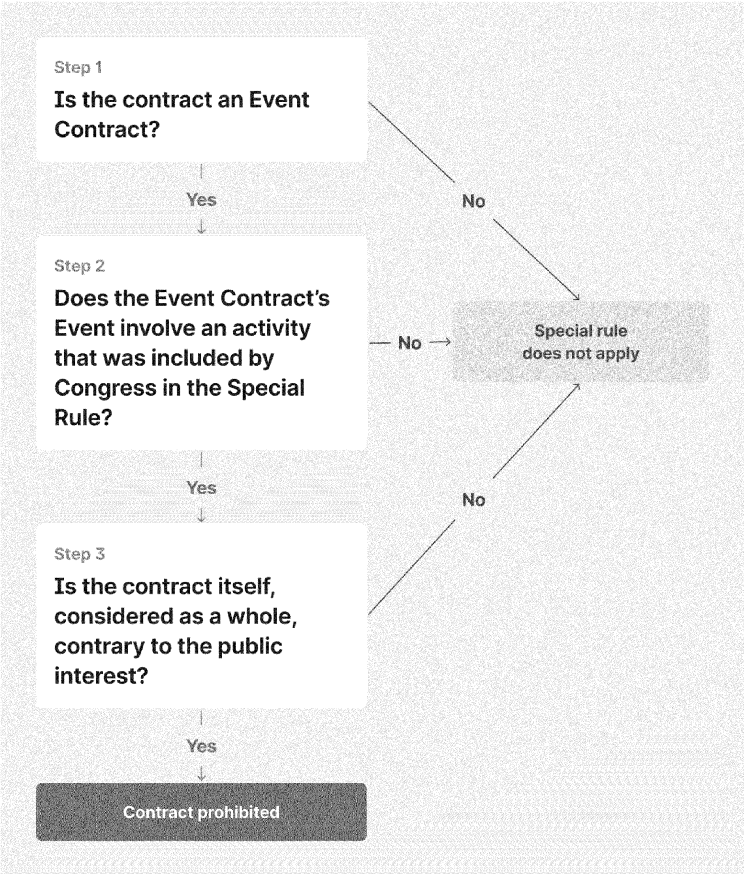
Graphically, the flow of the three steps looks like this:

[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*.

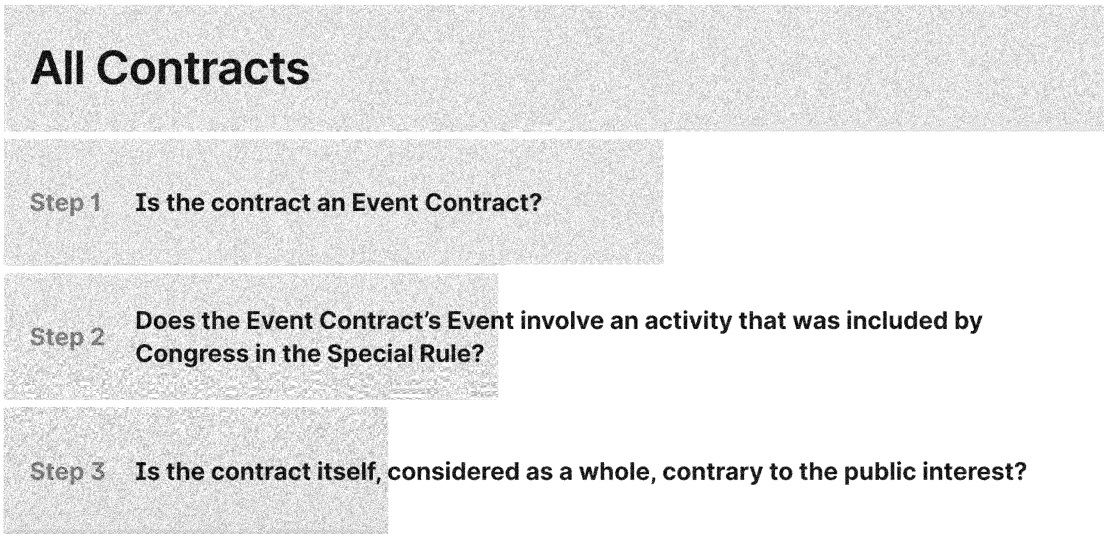
[16] 7 U.S.C. 7a-2(c)(5)(C)(ii). ("No agreement, contract, or transaction determined by the Commission to be contrary to the public interest under clause (i) may be listed or made available for clearing or trading on or through a registered entity.")

Kalshi



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.

Kalshi



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]

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[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.

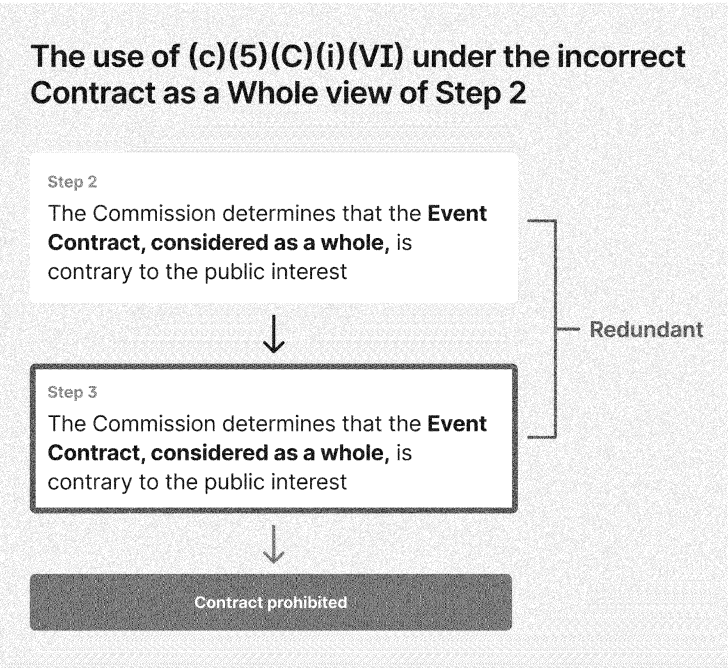
of the Event Contract, considered as a whole, where it has already been determined under Step Two that the *trading itself* is contrary to the public interest, i.e. that the Event Contract, considered as a whole, is contrary to the public interest. This results in two consecutive steps that do the exact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

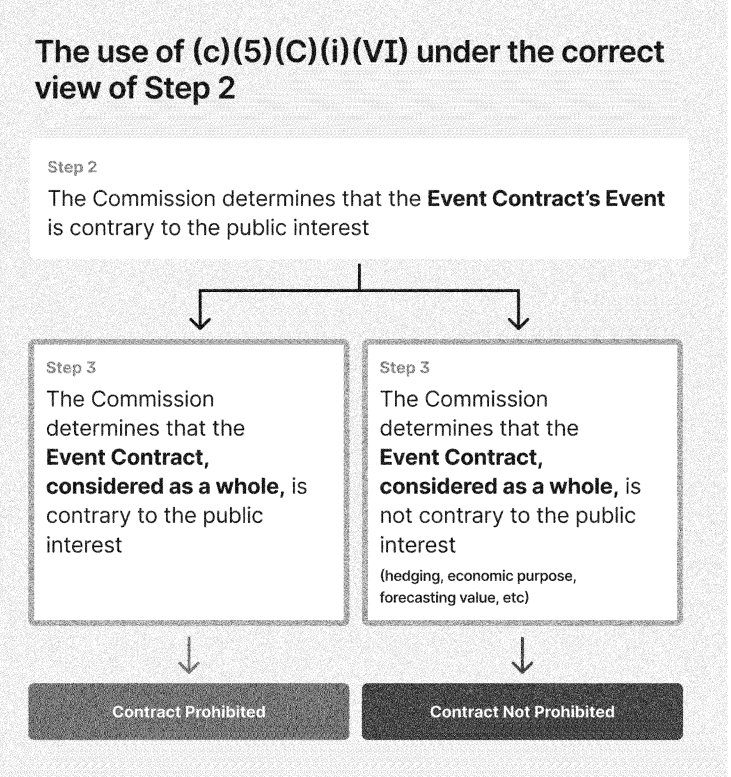
- Step Two: the Commission determines that the Event Contract, considered as a whole, is contrary to the public interest
- Step Three: the Commission determines that the Event Contract, considered as a whole, is contrary to the public interest (*again*)

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.

Kalshi


The use of (c)(5)(C)(i)(VI) under the incorrect Contract as a Whole view of Step 2
Step 2
The Commission determines that the Event Contract, considered as a whole, is contrary to the public interest
Redundant
Step 3
The Commission determines that the Event Contract, considered as a whole, is contrary to the public interest
Contract prohibited


The use of (c)(5)(C)(i)(VI) under the correct view of Step 2
Step 2
The Commission determines that the Event Contract's Event is contrary to the public interest
Step 3
The Commission determines that the Event Contract, considered as a whole, is contrary to the public interest
Contract Prohibited
Step 3
The Commission determines that the Event Contract, considered as a whole, is not contrary to the public interest
(hedging, economic purpose, forecasting value, etc)
Contract Not Prohibited

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 assasination) 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

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 Order[24] ("*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.

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[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.

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[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.

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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Confidential Treatment Requested by KalshiEX LLC

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

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/ifdocs/nadexorder040212.pdf.

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/CommissionRulemakingExplained/index.htm#_ftn1.

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

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.

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[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).

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:

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[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/.

> …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.

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]

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[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/berkovitzstatement040721 ("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").

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 Marcus

Jonathan L. Marcus

Cc: Eliezer Mishory
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Confidential Treatment Requested by KalshiEX LLC

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.

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,**

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[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

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[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 meaningful 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

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[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.

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[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 Order[24] 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

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[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

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

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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,"

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[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.

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[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