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Fight Over Political Event Futures Contracts Remains Contentious

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On September 22, the U.S. Commodity Futures Trading Commission (the "CFTC" or the "Commission") issued an order disapproving the listing and trading of congressional control event contracts by KalshiEX, LLC (the "Kalshi Order"), a designated contract market ("DCM"). The disapproval, which follows the Commission's withdrawal of its no-action position regarding PredictIt—an online prediction market that allows participants to trade swaps and futures contracts on political election outcomes—represents another blow to event contracts based upon political events. (We previously covered the Commission's PredictIt no-action letter withdrawal (the "Withdrawal") and review of Kalshi's congressional control event contracts (the "Kalshi Contracts") here.) However, the procedural circumstances of both actions mean that the fight is far from over.

As we noted in our prior coverage, PredictIt brought a challenge to the CFTC's decision in the U.S. District Court for the Western District of Texas on September 9, 2022, requesting a preliminary injunction preventing the Withdrawal from going into effect. Over a year later, on September 12, the Fifth Circuit Court of Appeals issued a mandate remanding the case to the District Court with instructions to enter a preliminary injunction in favor of PredictIt. The Court of Appeals' ruling is based upon its determination that the Withdrawal constituted a final agency action —making the Fifth Circuit the only court ever to issue such a holding.

According to the Kalshi Order, the Kalshi Contracts would be offered as cash-settled, binary contracts based on the question: "Will be controlled by for?" The settlement values would be determined by the party affiliation of the leader of the identified chamber of Congress upon every two-year term. Certain individuals and entities would be prohibited from trading the contracts—including Congress, candidates for federal and statewide public office, Congressional staffers and employees of party organizations, polling organizations, and PACs.

Following the Commission's public comment period and review, it determined that the Kalshi Contracts violate CFTC Regulation 40.11(a) and Section 5c(c)(5)(C)(i)-(ii) of the Commodity Exchange Act ("CEA"), which prevent registered entities (*e.g.*, DCMs) from listing or making available for clearing or trading contracts that involve gaming and activity that are unlawful under State law, or that are contrary to the public interest.

Some highlights of the Commission's reasoning from the Kalshi Order are below:

1. The Commission determined that the definition of "gaming" includes "the act of staking something of value on the outcome of a contest of others", and that an election is a contest between electoral candidates. The Commission averred that "futures contracts traditionally have not been premised on the outcomes of a contest of others" but have "served hedging and risk management functions."
2. The Commission rejected Kalshi's argument that state statutes and common law that prohibit betting or wagering on elections are pre-empted by the Commission's jurisdiction over futures and swaps pursuant to the CEA.
3. The Commission determined that the Kalshi Contracts do not serve a public interest (in particular, with respect to hedging and price basing) in that the economic impacts of Congressional elections are "too diffuse and unpredictable to serve the hedging and risk management functions." For example:
    - The Kalshi Contracts "have no underlying cash market with bona fide economic transactions to provide directly correlated price forming information" and their price forming information "is driven in large measure by polling, voter surveys" and other "opaque" and "unregulated" processes; and
    - Their binary payout and frequency of settlement "further limit[] their utility as a vehicle for hedging any eventual economic effects resulting from which party controls a chamber of Congress."
4. The Commission determined, in concert with over 600 commenters (which included members of Congress themselves), that the Kalshi Contracts threaten the public good in that they could (or be perceived to) impact election integrity, which could, by extension, "require the Commission to assume a role in overseeing the electoral process." The Commission reasoned that the lack of regulation of the price-forming information for the Kalshi Contracts could increase the risk of manipulative activity, and the trading prohibitions set forth would not exclude all individuals who could be motivated to engage in such manipulation.
    - To this end, Chair Behnam, in his statement, noted that, "It makes sense for the CFTC to have authority to combat fraud, manipulation, and false reporting in underlying commodity markets. But it is impractical for the CFTC to combat them in the underlying market here—a political contest. The implications of such authority are vast, and could extend in a multitude of directions beyond the election itself, political fundraising and polling, to name just two."

The ongoing battle in the PredictIt case, combined with the Kalshi Order, is likely to force the Commission's hand further in making a definitive finding whether political events contracts are gaming and contrary to the public interest under CEA

5c(c)(5)(C). Commissioner Caroline D. Pham abstained from the vote on the Kalshi Order, averring that any decision from the Commission with respect to the Kalshi Contracts may violate the Fifth Circuit's May 1 injunction in the PredictIt case against the Commission from "otherwise 'prohibiting or deterring the trading' of contracts listed on the PredictIt Market." Additionally, in her dissent, Commissioner Summer K. Mersinger expressed her support for a notice-and-comment rulemaking on event contracts, and disagreed with the Commission's findings in nearly every aspect of the Kalshi Order, noting, in particular, that "an economic purpose test ..." is not mentioned in the CEA and was not designed for these types of contracts."