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).

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)

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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").

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. .

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

[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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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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).

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

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

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

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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/.

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

Finally, 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]

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

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

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III. CONCLUSION

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

Very truly yours,

Jonathan 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
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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

[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.

[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