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No Safe Bet in the Legal Fight Over Political Event Contracts

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The CFTC's attempt to ban political event contracts is on hold for now and faces a difficult road ahead. In the year since it decided that KalshiEX LLC could not list such contracts for trading, the Commission has been forced to defend itself in court—thus far, unsuccessfully.

On October 2, the D.C. Court of Appeals handed the CFTC its latest defeat, denying its emergency motion to stay the lower court's ruling that Kalshi could list its political event contracts for trading.

It is difficult to predict whether the CFTC will eventually win this case on the merits. But even if it wins the war, its lost battles may lead the CFTC to take a more careful approach the next time it is asked to approve a novel product.

Background

KalshiEX LLC is a designated contract market authorized by the CFTC to list event contracts for public trading. In June 2023, Kalshi self-certified to the Commission that its Congressional Control Contracts—which allow people to take a position on which political party will control each chamber of Congress—complied with the CEA and the CFTC's regulations.

The CFTC was not so sure. It reviewed Kalshi's contracts under CFTC Regulation 40.11, which says that DCMs "shall not list for trading or accept for clearing" any contract that "involves. . . terrorism, assassination, war, gaming, or an activity that is unlawful under any State or Federal law." Regulation 40.11 also prohibits listing contracts that the CFTC finds are "contrary to the public interest."

As the CFTC conducted its review, politicians like Senators Elizabeth Warren and Jeff Merkley were quick to voice their opposition to Kalshi's contracts. In a letter to the CFTC, the Senators called them "a clear threat to our democracy and elections," and urged the Commission to deny Kalshi's proposal.

The Commission did just that, finding that Kalshi's contracts involve gaming and activity that is unlawful under state law and that they are contrary to the public interest, and ordering that Kalshi could not list or trade these contracts.

KalshiEX LLC v. CFTC

Kalshi promptly sued the CFTC in the U.S. District Court for the District of Columbia. The Court sided with Kalshi, finding that the CFTC had exceeded its statutory authority and that Kalshi's Congressional Control Contracts do not involve unlawful activity or gaming. Rather, the Court explained, these contracts involve elections, which are not unlawful activity or gaming.

But the fight did not end there. The CFTC immediately filed an emergency motion to stay, which Kalshi opposed. The Court heard oral arguments a few days later and denied the CFTC's written motion as well as its oral motion for stay pending appeal. Kalshi swiftly launched its contracts but was forced to pause them just hours later when the Circuit Court of Appeals ordered the District Court's decision be stayed pending appeal.

On September 19, the D.C. Circuit Court heard oral arguments on the CFTC's emergency motion to stay. The three-judge panel battered both sides with intense questioning for over two hours, stating several times that they did not follow certain arguments from both parties.

Less than two weeks later, on October 2, the Court issued a unanimous decision denying the CFTC's emergency motion to stay. It held that the Commission failed to demonstrate that it or the public would be irreparably harmed while its appeal is heard, a requirement for granting a stay pending appeal.

The Court acknowledged that the broader question on the merits that this case presents is a "close and difficult" one. We agree, and making a prediction as to when and how the Court will eventually rule on that question is difficult, too. For now, one thing is for sure: Kalshi is free to offer its Congressional Control Contracts for trading.

Broader Context

Kalshi is not the CFTC's first or only legal battle over election betting. It's still fighting with PredictIt—an online prediction market based in New Zealand that offers trading on political event contacts—in Texas federal court. The Fifth Circuit found that the Commission's rescission of its no-action letter to PredictIt was likely arbitrary and capricious. While the legal question in that case differs from *Kalshi*, the decision dealt a similarly significant blow to the CFTC, and the agency faces an uphill climb to victory.

Perhaps in response to the legal setbacks it has faced, in May of this year, the CFTC proposed amendments to Regulation 40.11. It would change "gaming" to include "staking or risking something of value on the outcome of a political contest." The revised rule would also define trading on political outcomes as "contrary to the public interest." In other words, the new rule would ban political event contracts from being listed for trading or accepted for clearing.

The Court of Appeals seemed to prefer that approach. In its decision, the Court noted that the CFTC "has long had—and still has—the power to forbid [election contracts] on the exchanges it regulates" through rulemaking. It could find that such contracts are "contrary to the public interest" and forbid them entirely, but "the Commission has not invoked the very tool Congress gave it" to head off the harms it claims election contracts pose.

The CFTC will now have to decide if, when, and how it will finalize the rulemaking to amend Rule 40.11, a decision that is more complicated now than it may have been several years ago.

Future Implications

The CFTC has made its ultimate goal clear: it wants to ban political prediction markets in the United States. But its approach has been met with skepticism from judges and the public alike, perhaps unsurprisingly because it differs so drastically from the CFTC's typical case-by-case consideration of new products. Time will tell if and how the CFTC will succeed—either from favorable court decisions or through rulemaking, or if it will lose altogether. It is difficult to predict how this will play out.

The only bet we are willing to make is that the CFTC will continue to face aggressive legal challenges to its authority.

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